The "Independent" Sector: Fee-for-Service Charity and the Limits of Autonomy

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The "Independent" Sector: Fee-for-Service Charity and the Limits of Autonomy

Lloyd Hitoshi Mayer 65 Vand. L. Rev. 51 (2012)

Although numerous scholars have attempted to explain and justify the benefits provided to charities, none has been completely successful. Their theories share, however, two required characteristics for charities. First, charities must be distinct from other types of entities in society, including governmental bodies, businesses, other types of nonprofit organizations, and informal entities such as families. Second, charities must provide some form of public benefit. Focusing on these common characteristics reveals a previously not fully appreciated role for the laws governing charities: protecting charities from influences that could potentially undermine these traits. Applying this new "autonomy perspective" to the law governing charities reveals that while existing legal rules generally protect charity autonomy, they fail to do so in one major respect. Current law does not directly address the growing and often negative influence of consumers who purchase services from charities primarily for the consumers' own benefit and with little if any regard to the public benefit charities must provide. Having identified this vulnerability, this Article then samples the existing empirical literature regarding fee-dependent charities to determine under what conditions the influence of these consumers, whether patients, students, retirement community residents, or others, is likely to be detrimental to a charity's pursuit of public benefit, and what options exist for addressing this influence. It concludes with suggestions for further research that would help lawmakers accurately target this influence and so better address questionable behavior by charities.
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Lloyd Hitoshi Mayer*

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* Professor, Notre Dame Law School. I am very grateful for comments from Evelyn Brody, John Colombo, Miranda P. Fleischer, Dana Brakman Reiser, Brendan Wilson, and the participants in presentations at Brooklyn Law School, Harvard Law School, University of Illinois College of Law, Indiana University Mauer School of Law-Bloomington, Notre Dame Law School, and Washington University School of Law. I also greatly appreciate the research assistance of Benjamin Anderson, Benjamin Beiter, Katherine Ann Sebastiano, and Elizabeth M.Z. Timmermans.
INTRODUCTION

There is a perception among some academics, government officials, and others that many charities may not be worthy of the legal benefits that they enjoy. These critics have focused in particular on charities that rely heavily on fees and engage in allegedly noncharitable activities ranging from aggressive bill collection practices to the imposition of high and increasing charges, as well as

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2. See, e.g., Fred Stokeld, Becerra Says Exempt Organizations Must Police Themselves, 64 EXEMPT ORG. TAX REV. 11 (2009) (reporting on comments by Representative Xavier Becerra that tax-exempt organizations must do a better job policing themselves via increased transparency); Senator Charles Grassley, Remarks on Charities and Governance at Buchanan, Ingersoll & Rooney (Mar. 10, 2009), available at http://grassley.senate.gov/news/Article.cfm?customel_data PageID_1502=19725 (expressing a desire to make charities more accountable for tax breaks given to them).


generally the failure to provide sufficient public benefit. Yet these criticisms almost always fail to identify the underlying cause of the questioned behaviors and, when they do identify the cause, they fail to address it.

This Article seeks to remedy these concerns by identifying who or what may be causing charities to pursue activities that do not provide public benefit, rather than developing proposals to counter specific practices. By focusing on the critical role of autonomy and carefully considering the outside influences that impact charities, this Article sheds fresh light on the current legal framework for charities. This new autonomy perspective reveals that such laws serve in large part to eliminate or restrict outside influence and so ensure that charities provide significant public benefit. This analysis also reveals, however, one significant gap in this protection: current law does not generally limit the influence of self-seeking consumers who pay charities for services. It is therefore the purchasers of these services—patients of charity hospitals, students at nonprofit schools and their parents, and others—who appear to be the primary force causing charities that rely heavily on such purchasers to depart from providing public benefit. To counter such departures therefore requires reducing or counterbalancing this consumer influence.

Part I of this Article examines the theories of why charities exist and enjoy significant legal benefits. It concludes that almost all of the disparate rationales for the existence and support of charities attribute two common characteristics to charities. First, charities are distinct from entities in the other sectors of society and so perform functions that will not be done, or not done as well, by those other entities. Second, charities provide some form of significant public benefit. Significant public benefit is required because the law not only tolerates but in numerous ways supports charities at the cost of

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5. See, e.g., Charles E. Grassley, Wealthy Colleges Must Make Themselves More Affordable, 54 CHRON. HIGHER EDUC., May 30, 2008, at 36 (expressing concern that growing college endowments and other resources are not used to decease ever-increasing tuition costs).

6. See, e.g., David A. Hyman, The Conundrum of Charitability: Reassessing Tax Exemption for Hospitals, 16 AM. J.L. & MED. 327, 375–76 (1990) (noting that the IRS uses community benefit as the operative test for nonprofit tax designation of nonprofit hospitals even with difficulties in measuring the intangible qualities that define community benefit); George A. Nation III, Non-Profit Charitable Tax-Exempt Hospitals—Wolves in Sheep’s Clothing: To Increase Fairness and Enhance Competition in Health Care All Hospitals Should Be For-Profit and Taxable, 42 RUTGERS L.J. 141 (2011) (arguing that most nonprofit hospitals do not provide a public benefit equal to the tax benefit they receive).
diverting funds from other activities. For charities to be charities (i.e., to have these two characteristics) the law must protect them from other societal actors who intentionally or inadvertently would damage or destroy these defining characteristics.

Part II analyzes the current laws specifically applicable to charities from this new autonomy perspective. It finds that almost all of these laws, even though enacted over many years and often with little explanation, serve to limit the influence of individuals and groups on charities when such influence would likely compromise the ability of charities to fulfill their identified roles. This systematic review of existing legal rules reveals, however, one major weakness. Current law fails to protect fee-dependent charities from the collective desires of their consumers, desires that often may prioritize enhancing the consumers' private benefits over providing public benefit.

Part III explores this weakness. It begins by describing how fees have become an increasingly important source of revenue, especially for certain types of charities. This Part then samples the existing empirical literature regarding fee-reliant charities to determine how the resulting influence of consumers may be blunted or even eliminated depending on market and other conditions. Relevant market conditions may include imperfect consumer information, high barriers to entry, and limited market size resulting in limited competition. Other relevant conditions may include third parties with legal or other authority over charities, such as accreditation bodies or religious organizations. The Part concludes that the existing empirical evidence strongly indicates that the presence of such factors, and therefore the strength of consumer influence, is likely to vary significantly not only between charities engaged in different types of activities—for example, universities versus child care centers—but also within charities engaged in the same type of activities—for example, rural hospitals versus urban hospitals.

Using the available data, the final Part considers various options for addressing this potential vulnerability. These options range from draconian restrictions, such as denying charitable status to organizations that charge more than nominal amounts for their services, to more modest restrictions. It concludes that, given the significant variation in the strength of consumer influence, there is no one-size-fits-all solution. Rather, which of the various solutions is most appropriate depends on careful consideration of the market conditions and other factors that affect the extent to which consumer demands are likely to pull a specific charity or a specific type of charity away from providing a public benefit. This Part therefore suggests criteria for deciding among the various options given the
variability in conditions faced by charities that rely heavily on fees for services for financial support. The Article concludes by suggesting directions for further research drawing on this autonomy perspective.

I. THE ROLE OF CHARITIES

To understand the role of charities, it is first important to be clear what we mean when we use the term “charity.” The first Section addresses that definitional issue. The next two Sections review the theories that explain the existence of charities and the related theories that justify the significant legal benefits enjoyed by charities in order to develop a complete picture of the role of charities in our society.

A. What Is a Charity?

Sociologists and others who study how societies organize themselves have identified four sectors of formal and informal organizations. These four sectors are the market, the government, families and other informal groupings, and nonprofit organizations. The sectors are distinguished by their different characteristics—voluntary versus involuntary, profit seeking versus mutual or public benefit seeking, formal versus informal organization, and so on—and their resulting roles or functions. Some organizations do not easily fall within a single sector, and there are numerous boundary issues, but the vast majority of organizations fall into one or the other of these four areas.

Of these four sectors, the nonprofit sector is the most recent to be identified, and, perhaps for that reason, it is the least well defined. The term “nonprofit” is itself misleading because many of the organizations within this sector in fact produce profits, although seeking profits is not their primary purpose. Even identifying a set of


8. See PETER FRUMKIN, ON BEING NONPROFIT: A CONCEPTUAL AND POLICY PRIMER 3–5 (2002) (noting that the structural features of nonprofits give them advantages that business and government sectors cannot match); VAN TIL, supra note 7, at 18–28 (describing various criteria used to categorize organizations).

9. See SALAMON & ANHEIER, supra note 7, at 3 (explaining that the nature and capabilities of the nonprofit sector are not sufficiently understood).
collective characteristics that distinguish this sector from the other three has proven difficult.\textsuperscript{10} It is not necessary, however, to clarify further the definition of the nonprofit sector because the focus here is not on the nonprofit sector as a whole but on a subset of that sector.

This Article will refer to that subset as "charities" and define them based on the fact that they both fall within the nonprofit sector and enjoy legal benefits that are not shared by other nonprofit organizations, particularly the ability to claim federal income tax exemption and to receive contributions that are deductible for federal tax purposes.\textsuperscript{11} Eligibility for such legal benefits is critical because it is this characteristic that gives the government the power and arguably the right to place limits on the activities of these entities even with respect to matters that the Constitution normally protects from government regulation.\textsuperscript{12}

B. Theories Explaining the Existence of Charities

Having identified a set of organizations that are distinct from governmental entities, businesses, and informal groups (e.g., families), the following questions naturally arise: Why did this distinct set of organizations come to exist, and why did legislators choose to create legal regimes (e.g., nonprofit corporation laws) to accommodate their existence? These questions are particularly important with respect to

\begin{itemize}
\item \textsuperscript{10} See, e.g., FRUMKIN, supra note 8, at 3 (expressing that defining the fundamental features that all nonprofits share is “a complex and daunting task,” but identifying three shared characteristics: “(1) they do not coerce participation; (2) they operate without distributing profits to shareholders; and (3) they exist without simple and clear lines of ownership and accountability”); SALAMON & ANHEIER, supra note 7, at xvii–xviii (identifying five common characteristics of nonprofits: “(a) formally constituted; (b) organizationally separate from government; (c) non-profit-seeking; (d) self-governing; and (e) voluntary to some significant degree”).

\item \textsuperscript{11} See, e.g., MOLLY F. SHERLOCK & JANE G. GRAVELLE, CONG. RESEARCH SERV., R40919, AN OVERVIEW OF THE NONPROFIT AND CHARITABLE SECTOR 2 (2009) (defining “charitable organization” in this manner); Simon et al., supra note 7, at 268 (using “charity” in this manner).

\item \textsuperscript{12} Compare Regan v. Taxation with Representation, 461 U.S. 540, 544–46 (1983) (upholding as constitutional the charity lobbying limit because Congress has authority to restrict the type of speech funded by the tax exemption and deductible contributions “subsidy”), with Citizens United v. Fed. Election Comm’n, 130 S. Ct. 876, 905 (2010) (rejecting the argument that legal advantages granted to corporations generally are sufficient to permit laws prohibiting corporate speech), and Trs. of Dartmouth Coll. v. Woodward, 17 U.S. 518, 646–50 (1819) (finding a state legislative attempt to effectively take control of a nonprofit organization to be an unconstitutional impairment of contract in large part because the organization was a private institution that relied on funds provided by individuals, even though the organization enjoyed the legal benefits of incorporation under state law). But see Evelyn Brody & John Tyler, Respecting Foundation and Charity Autonomy: How Public is Private Philanthropy?, 85 CHI.-KENT L. REV. 571, 599–600 (2010) (stating that federal tax benefits do not justify government interference with most aspects of charity governance and activities).
\end{itemize}
charities, for which the law does not merely provide accommodation but also provides many benefits. Numerous scholars have attempted to answer these questions, resulting in a plethora of theories, each of which almost certainly provides a valid, but partial, explanation. The most extensively developed set of theories uses what can be fairly characterized as a demand-side economic approach, while other theories follow a more supply-side, and often consciously noneconomic, path.

The demand-side economic theories focus primarily on the failures or limitations of the government and market sectors. With respect to the government sector, Burton Weisbrod and others have argued that governments will fail to provide certain collective goods that society, or segments of society, desire because (1) the desired good is unable to attract sufficient political support to cause the government to provide it; (2) the bureaucratic nature of government results in insufficient innovation and responsiveness, as well as excessive administrative costs; or (3) the government is legally barred from providing such goods. For example, governments may choose not to fund research into a cure for a particular disease because those who suffer from that disease are unable to muster sufficient political support to secure such funding or are unwilling to accept the costs and delays associated with obtaining and using such funding. Nonprofits, including charities, can overcome these failures. Nonprofits do not require the same level of public support as government action because they have neither the level of bureaucratization that exists in

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14. See Frumkin, supra note 8, at 19–22 (dividing these theories into demand-side and supply-side approaches).

government agencies nor the same legal restraints as governments (most notably with respect to religious activities).

With respect to the market sector, Henry Hansmann and others have argued that markets fail to produce desired goods or services when faced with either a free-rider situation or a contract-failure problem. The former case arises when there is no cost-effective way for the producer to charge some or all of the ultimate beneficiaries. For example, art in a public location might create this problem. A similar, if less extreme, situation exists where the producer can charge the primary beneficiary for the good or service but not secondary beneficiaries who enjoy positive externalities generated by the good or service. For example, education is often cited as such a service because educated individuals purportedly facilitate a robust democracy and strong communities.

"Contract failure" arises when the producer can provide the consumer with a substandard good or service that increases the producer's profit, and there is no cost-effective way for the consumer to detect this behavior. One example of this is the provision of a complicated service, such as health care, the quality and value of which is difficult to judge accurately, particularly for nonrepeat consumers. A recent example is the apparent preference for


17. See SHERLOCK & GRAVELLE, supra note 11, at 36 ("For example, education is thought to have positive externalities. Not only does the person receiving an education benefit, but educated people are better equipped to participate in a functional democracy."); Richard Morrison, Price Fixing Among Elite Colleges and University, 59 U. CHI. L. REV. 807, 831 (1992) (listing "heightened political participation, crime reduction, increased productivity, and increased knowledge" (citations omitted) as some of the social benefits of education).


19. See Femia Handy et al., The Discerning Consumer: Is Nonprofit Status a Factor?, 39 NONPROFIT & VOLUNTARY SECTOR Q. 866, 878-79 (2010) (nonprofits are generally perceived as more trustworthy than other types of entities by both potential supporters and customers); Mark Schlesinger et al., Public Expectations of Nonprofit And For-Profit Ownership in American Medicine, 23 HEALTH AFF. 181, 189 (2004) (concluding, based on a review of available surveys, that a solid majority of the public believes nonprofit health care agencies are more trustworthy
nonprofit organization providers in the charter school field. Another example is the provision of benefits to children in distant countries, where a thirty-dollar-a-month domestic “purchaser” of such benefits has no cost-effective way to monitor the quality of the benefits provided or even whether any benefits are provided at all. Nonprofits, including charities, can generally overcome both of these failures because they neither depend solely on payments from the beneficiaries of their goods or services nor are they driven by a profit motive to maximize net income.

There is no comparable set of economic or demand-side theories for how nonprofits provide goods and services that families or other informal organizations do not, but it is relatively easy to explain this oversight. At least in the United States, the predominant informal organizations are the family and the household (which often, but not always, overlap), and they usually are organized and share economic resources on a relatively small scale, thereby preventing them from engaging in activities that require even a modest-sized organization. It is therefore not surprising that proponents of these theories generally ignore these groups—even though in some domestic subcultures, families, households, and other informal groups are organized on a larger scale. That said, however, families and households do tend to operate on a relatively small scale in the United States and so are highly unlikely to have the financial and human-capital resources needed to operate an even medium-sized or semi-complicated activity, such as the activities engaged in by small educational, health care, and social service institutions.

Expanding beyond goods and services, some commentators argue that nonprofits also provide positive benefits to our democratic political process. For example, nonprofits may generate ideas,

and cheaper, but also that they provide lower quality care and are less efficient, when compared to for-profit owned health care providers).


23. See, e.g., Miriam Galston, Civic Renewal and the Regulation of Nonprofits, 13 CORNELL J.L. & PUB. POL’Y 289, 294–324 (2004) (summarizing different “civic renewal” perspectives regarding the role of voluntary associations); Saul Levmore, Taxes as Ballots, 65 U. CHI. L. REV. 387, 404–08 (1998) (arguing that the charitable contribution deduction serves as a mechanism for permitting taxpayers to choose the objects of government support); see also David Brennan, A
information, and political input from various groups, especially unrepresented or underrepresented ones. The latter groups may otherwise lack the ability to participate in the political process, and so have a voice in government, because of a combination of historical and resource issues. For similar reasons, charities may provide a different perspective than either businesses that are driven by their bottom-line concerns or governments controlled by political interests. This differing perspective not only enhances public debate but also can serve to challenge otherwise dominant views promoted by those entities that control political or economic power. Nonprofits generally and charities specifically may also serve as an additional check on government and market power and therefore fulfill an important democratic role in holding governments and for-profit entities accountable.

These political theories rest on both demand-side approaches that focus on the inputs that a democratic political process needs, and supply-side approaches, that develop an organizational form to provide a means for certain typically underrepresented populations to be heard in the public square. Supply-side approaches are not limited to groups seeking political participation, however. For example, Robert Atkinson has detailed how charities provide a vehicle for individuals to fulfill their altruistic desires collectively in a way that

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25. *See Giving in America, supra* note 24, at 42–43; Brennan, *supra* note 23, at 14–19; (arguing that HMOs and physician assistant programs arose because of nonprofit involvement); see also Keely Jones Stater, How Permeable is the Nonprofit Sector? Linking Resources, Demand, and Government Provision to the Distribution of Organizations Across Nonprofit Mission-Based Fields, 39 Nonprofit & Voluntary Sector Q. 674, 688 (2010) (finding an increased diversity of nonprofit organizations in more heterogeneous communities based on a nationwide study, although also finding that other factors affect the level of nonprofit diversity).

26. *See Giving in America, supra* note 24, at 44–45 (arguing that nonprofits' roles in "monitoring and influencing" government are growing increasingly important).
they cannot achieve by acting individually. Acting together voluntarily for the perceived greater good can also satisfy needs for community or fellowship that neither profit-seeking efforts in the market nor the forced working together of government can satisfy, thereby building social capital. While such supply-side motivations could perhaps be at least partially satisfied absent a formal, nonprofit organization outlet, the common argument of these theories is that the nonprofit form is a better outlet for such desires than other available vehicles, whether government agencies or for-profit, private entities.

Each of these various theories can be subject to criticisms, and none of them fully explain the existence of nonprofits generally or charities specifically. The reality is that when the focus is tightened to a specific type of charitable organization, often one theory provides a more viable explanation than others. For example, the economic, government-failure, and market-failure theories work best for charities involved in the production of certain types of goods and services that are particularly vulnerable to the identified government and market limitations. Similarly, the political theories have their greatest strength with respect to advocacy and information-providing organizations, such as civil rights groups and think tanks, but seem to have little application to charities focused on the provision of specific goods or services. Unique justifications also arguably exist for the

27. Rob Atkinson, Altruism in Nonprofit Organizations, 31 B.C. L. REV. 501, 505 (1990); see also FRUMKIN, supra note 8, at 21–24 (developing a supply-side, social-entrepreneur approach and noting that nonprofits give citizens the group structure required to give individuals the ability to affect change on local and national problems); GIVING IN AMERICA, supra note 24, at 46; Paul J. DiMaggio & Helmut K. Anheier, The Sociology of Nonprofit Organizations and Sectors, 16 ANN. REV. SOC. 137, 140–41 (1990) (identifying such supply-side factors as well as “institutional factors” such as “state policy, organizing norms, ideology and religion”); Usha Rodrigues, Entity and Identity, 60 EMORY L.J. 1257 (2011) (the nonprofit form provides a vehicle for creating a “warm-glow” identity).

28. See, e.g., COLOMBO & HALL, supra note 13, at 92–94 (summarizing criticisms of theories explaining tax treatment of charities); Fleischer, supra note 13, at 529–36 (criticizing the existing theories for not “adequately identify[ing] which projects merit subsidies”); Galle, supra note 15, at 14–38 (criticizing the government-failure theories); Henry Hansmann, The Changing Roles of Public, Private, and Nonprofit Enterprise in Education, Health Care, and Other Human Services, in INDIVIDUAL AND SOCIAL RESPONSIBILITY: CHILD CARE, EDUCATION, MEDICAL CARE, AND LONG-TERM CARE IN AMERICA 245, 254–55, 269 (Victor R. Fuchs ed., 1996) (questioning whether consumers of health care and education are likely to be unsophisticated and poorly informed such that they are vulnerable to information asymmetries as asserted by the contract-failure theory).

29. Precisely which goods and services have this characteristic is the subject of much debate. See, e.g., John D. Colombo, Why is Harvard Tax-Exempt? (and Other Mysteries of Tax Exemption for Private Educational Institutions), 35 ARIZ. L. REV. 841, 870 (1993) (arguing that higher education is less of a market failure than commentators suggest).
classification of religious organizations as charities, but those justifications are beyond the scope of this Article.\(^\text{30}\)

There is, however, a common theme between all of the various theories. What nonprofits do is something that cannot be done at all, or done as well, by the other sectors because of the inherent limitations of organizations in those sectors, whether that something is producing a particular good or service or providing an outlet for a particular individual or societal desire, such as altruism.\(^\text{31}\) Even though these theories are, for the most part, descriptive instead of normative, a normative question remains: Why are a subset of these groups (i.e., charities) affirmatively given substantial benefits? The next Section addresses the justifications for these extensive legal benefits.

\section*{C. The Legal Benefits Enjoyed by Charities}

This Section first describes the legal benefits that charities enjoy and summarizes the theories that justify granting such benefits to charities. It then explains why the concept of public benefit is the critical justification for these benefits, a justification that goes beyond the “nonprofits do it better” approach of most of the theories previously described.

\subsection*{1. The Legal Benefits}

Domestic law—federal, state, and local—grants significant benefits to charities.\(^\text{32}\) These benefits generally fall into two categories. The first category is benefits that effectively reduce the costs of obtaining inputs for a charity’s activities. This includes not only exemption from federal and usually state income taxes but also the tax deduction for contributions, access to tax-exempt bond financing, exemption from state and local taxes on real and personal

\begin{itemize}
  \item \textit{C. The Legal Benefits Enjoyed by Charities}
  \item 31. See, e.g., John D. Colombo, The NCAA, Tax Exemption, and College Athletics, 2010 U. ILL. L. REV. 109, 147 (2010) ("A common theme of virtually all these theories is that charities supply some sort of good or service, or 'way of doing things,' that is not replicated in the private market or by government.").
  \item 32. See generally Bazil Facchina et al., Privileges & Exemptions Enjoyed by Nonprofit Organizations, 28 U.S.F. L. REV. 85, 86–87 (1993) (summarizing the benefits that charities receive from federal, state, and local governments); Memorandum from Erika Lunder et al., Cong. Research Serv., to J. Comm. on Tax’n re Non-Tax Benefits Provided to Orgs. Described in IRC § 501(c)(3) (Feb. 16, 2005) [hereinafter Lunder et al. Memo] (summarizing the statutes of both the federal government and five states that confer legal benefits upon charities).
property, and exemption from sales and use taxes on the purchase of goods or services. Current estimates of the cost to the government of the tax-related benefits alone are between $70 and $80 billion per year.

The second category of benefits is partial or complete exclusion from the application of many federal and state laws, including securities laws, or other special accommodations. While the reasons behind these exemptions are generally less than clear because of sparse or nonexistent legislative history, such exemptions appear to primarily flow from a belief that charities by their nature are unlikely to engage in the bad acts these laws seek to prevent and so are not the proper subjects of the rules. It is beyond the scope of this Article to


34. See OFFICE OF MGMT. & BUDGET, ANALYTICAL PERSPECTIVE, BUDGET OF THE U.S. GOVERNMENT: FISCAL YEAR 2012, at 211 (2011) (estimating the total cost of the federal income tax charitable contribution deduction for fiscal year 2010 at $41.9 billion and the exclusion of interest on bonds for construction of hospitals and private nonprofit educational facilities at $5.9 billion); STAFF OF JOINT COMM. ON TAXATION, 111TH CONG. ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2010–2014, at 45, 47, 48 (Comm. Print 2010) (estimating the total cost of the federal income tax charitable contribution deduction for fiscal year 2010 at $40 billion); Evelyn Brody & Joseph J. Cordes, Tax Treatment of Nonprofit Organizations: A Two-Edged Sword?, in NONPROFITS & GOVERNMENT, supra note 24, at 141, 149–51 (estimating the value of federal and state income tax exemptions to charities at $10 billion annually in 2002 and of property tax exemptions at between $10 and $20 billion annually).


36. See, e.g., H.R. REP. NO. 102-317, at 16–17 (1991) (excluding charities from the reach of laws limiting telephone solicitations on the basis that there was not sufficient evidence to conclude that such calls from charities were unwanted or unexpected and that there were potential constitutional issues raised by restricting such calls); H.R. REP. NO. 86-1766, at 24, 28 (1960) (explaining the exemption for charities from federal unemployment tax by simply stating that they are not engaged in activities for profit); H.R. REP. NO. 75-2161, at 1 (1939) (stating that the partial exclusion of purchases by charitable and similar institutions from the Robinson-
address whether that belief is correct, although it tends to fit with the general view, discussed below, that charities, when properly constrained by the law, will seek to provide a public benefit and so are less likely to pursue questionable or harmful actions that are usually motivated by a desire for private benefit.

2. Theories Justifying the Legal Benefits

Given the extent of indirect financial and other assistance provided to charities another question arises: Why should this particular subset of nonprofits require or deserve this assistance? One set of “tax base” theories, developed by William Andrews, Boris Bittker, and others, concludes that exemption and deductibility of contributions are appropriate because a properly defined income tax base would exclude from taxation both nonprofit net income and funds contributed to charities.37 There are, however, significant gaps in these theories as their supporters have acknowledged and other commentators have noted.38 For example, these theories do not explain the availability of the charitable contribution deduction for the full value of appreciated property and may not explain the deduction at all, in that such contributions are voluntary and unrelated to the

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37. See, e.g., William D. Andrews, Personal Deductions in an Ideal Income Tax, 86 HARV. L. REV. 309, 345–46 (1972) (discussing reasons why charitable contributions may rationally be excluded from taxable personal consumption to support the argument that charitable deductions can be seen as a refinement in the definition of what is taxed); Boris Bittker, Charitable Contributions: Tax Deductions or Matching Grants?, 28 TAX L. REV. 37, 38, 62–63 (1972) (affirming the “propriety and vitality” of deductions for charitable contributions and proposing a repeal of percentage limits, deductions for donations to charitable contributions as business expenses, “a minimum contribution amount for eligible deductions, and a reexamination of the deductibility of fair market value of appreciated capital assets); Johnny Rex Buckles, The Community Income Theory of the Charitable Contributions Deduction, 80 IND. L.J. 947, 952–53 (2005) (arguing that the charitable contributions deduction can be defended as part of “community income,” an income which is properly excluded from the personal income tax base).

38. See, e.g., COLOMBO & HALL, supra note 13, at 24 (highlighting the problems with accepting a tax-base theory as an explanation of the entire scope of charitable exemption); Andrews, supra note 37, at 371–72 (challenging the justification for charitable contribution deductions in cases of wealthy taxpayers with accumulated wealth or unearned income); Daniel Halperin, Is Income Tax Exemption for Charities a Subsidy?, 64 TAX L. REV. 283 (2011) (utilizing a subsidy theory to consider the appropriateness of the exemption’s application to a charity’s investment income).
production of income, so it is unclear why they should not be considered (taxable) consumption even under a tax base approach.39

A more comprehensive set of “subsidy” theories focuses on the relative disadvantages charities face in obtaining financial support as compared to groups in the other sectors and other nonprofit organizations. Charities share with all other private entities the inability to compel financial support (i.e., to tax). Unlike businesses, however, charities are also unable to access the equity markets because of the “nondistribution constraint”—the prohibition on having owners with a right to distributions of profits.40

Charities also differ from other types of nonprofit organizations and families because they do not have a strong ability to convince their members to support their activities financially. Noncharitable nonprofit organizations are generally “mutual benefit” nonprofits that exist primarily to serve their members.41 Common examples of such nonprofits include labor unions, trade associations, chambers of commerce, professional associations, country clubs, and homeowners associations. As explained by Mancur Olson, such groups can attract financial support from their members by offering benefits to participants—that is, to members—which are not available to nonparticipants.42 For example, the American Bar Association offers

39. See Andrews, supra note 37, at 371–72 (describing how the law allows a deduction for the fair market value of appreciated capital assets without taking into account unrealized gains by that value exceeding the taxpayer’s basis); Paul R. McDaniel, Study of Federal Matching Grants for Charitable Contributions, in IV COMM’N ON PRIVATE PHILANTHROPY AND PUB. NEEDS, RESEARCH PAPERS SPONSORED 2417, 2422–23 (1977) [hereinafter RESEARCH PAPERS] (detailing the tension between theoretical perspectives of the deduction system—theories which rationalize deductions for voluntary contributions as rewarding sacrifices to the public good or incentivizing “consumption spending”).


41. See REVISED MODEL NONPROFIT CORP. ACT § 17.07 (1987) (dividing nonprofit corporations into public benefit, mutual benefit, and religious corporations, with mutual benefit being the residual category); see also CAL. CORP. CODE §§ 5059–5061 (West 1990) (dividing nonprofit corporations into “mutual benefit,” “public benefit,” and “religious” categories); N.Y. NOT-FOR-PROFIT CORP. LAW § 201 (McKinney 2005) (dividing nonprofit corporations into categories based on purpose). But see MODEL NONPROFIT CORP. ACT § 1.40 cmt. 3 (3d ed. 2008) (noting the decision to abandon this formal division in the most recent edition of the model nonprofit corporation act).

42. MANCUR OLSON, JR., THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS 133 (1965). Some of these organizations, particularly labor unions, also may be able to force potential free riders to become supporters through the operation of law. See 29 U.S.C. § 158(a)(3) (2006) (permitting an employer to agree with a labor organization to require membership in the organization as a condition of employment, subject to certain conditions); OLSON, supra, at 136–37 (noting that labor unions began to prosper only after employers had the
its members access to various group insurance products that they otherwise could not access. Some nonprofits, however, are not able to identify or enlist their potential beneficiaries because the benefits are too diffuse to trace to particular recipients or the benefit to any particular beneficiary is too small to make offering such incentives practical, resulting in what could be termed “membership failure.” Recent evidence indicates that even religious organizations are vulnerable to this membership failure, as they appear to have at best a relatively limited ability to convince their members to provide financial support.\textsuperscript{43} For families, both legal pressures (such as child welfare laws and child support obligations in the event of divorce) and social pressures exist to motivate members to contribute to the well-being of the group, and it is difficult for family members to “opt out” of those obligations.

But resting the additional legal benefits that charities enjoy on this apparent financial disadvantage as compared not only to government and businesses, but also to mutual benefit nonprofits and families, has two significant flaws. First, it is far from clear that this financial disadvantage is significant enough to justify the magnitude of the financial assistance provided by these benefits.\textsuperscript{44} Second and more fundamentally, it is not clear why charities should be placed on the same financial footing as these other entities.\textsuperscript{45} Moreover, given the difficulty of even identifying which goods or services are more efficiently provided by nonprofits, as opposed to government or businesses, it is an even further leap to assume that nonprofits provide a given subset of those goods and services so much more efficiently that it justifies the existing subsidies for charities. Together these flaws suggest there should be some additional justification for the indirect financial support provided through the broad range of

\textsuperscript{43} See CHRISTIAN SMITH & MICHAEL O. EMERSON, PASSING THE PLATE: WHY AMERICAN CHRISTIANS DON’T GIVE AWAY MORE MONEY 36–37 (2008) (citing a 1998 General Social Survey which illustrates that the median U.S. Christian giver donated only two hundred dollars to all charities, including their church, that nearly half of regular churchgoers gave less than two percent of their incomes, and that less than ten percent tithed).

\textsuperscript{44} See supra note 34 and accompanying text (estimating that in the aggregate, such benefits are worth tens of billions of dollars annually); see also Daniel Shaviro, Assessing the “Contract Failure” Explanation for Nonprofit Organizations and Their Tax-Exempt Status, 41 N.Y.L. SCH. L. REV. 1001, 1006 (1997) (arguing that the nondistribution constraint may not in fact result in reduced “investment” in nonprofit organizations).

\textsuperscript{45} Even if the financial disadvantages summarized above are not only real but substantial, their effect—absent the indirect financial assistance charities enjoy—would presumably be to limit, but not extinguish charities.
legal benefits that charities generally enjoy. This additional justification is found in the concept of "public benefit."

3. The Key Requirement: Public Benefit

This public benefit theory is an alternative explanation—not merely an implementation of previously described theories—for why charities are given unique legal status. This can be shown by a few examples. With respect to the demand-side theories, the mere fact that an organization can garner some modest measure of public support and is not burdened with the bureaucracy inherent in most government entities does not inherently prevent such an organization from serving a relatively small, distinct group for its own benefit, whether that group be lawyers, businesses in a particular industry, or workers for a particular employer. Similarly, the mere fact that information asymmetries with respect to a given service may exist does not inherently require that this service provide a benefit to the diffuse public. For example, the quality of legal services would appear to be as difficult to judge for the nonrepeat user as education or hospital care, and yet unlike these latter two services it has never been suggested that the provision of legal services provides public benefit such that an organization could qualify as a charity solely on the basis of providing these services.46

It is true that some of the sector-based theories—particularly the impossible or difficult to capture externality market-failure explanation47—inherently require public benefit. But, as already noted, these theories do not necessarily fit well with all of the actual examples of organizations long-considered charitable. For example, the coexistence of for-profit entities in some areas where charities are active, such as health care, retirement communities, child care, and increasingly education, suggests that the externality problem is not insurmountable, at least in some situations. As for the supply-side altruism, social entrepreneur, and similar theories, they do not depend on differentiation from organizations in the other sectors but instead explicitly rely on some type of public benefit being provided, although under each theory the specifics of what qualifies as a public-benefit-providing activity is left to private parties, not the government, as long as such activities further one or more broadly

46. See Shaviro, supra note 44, at 1002–03 (examining why there are nonprofits in fields such as charity work but not in automobile repair).

47. See supra notes 16–17 and accompanying text (discussing variations on government-failure and market-failure theories).
defined purposes. Finally, proponents of the political theories generally view providing representation for underrepresented groups or for a viewpoint distinct from that of market and government actors to be inherently beneficial to society.

The law, both historically and currently, has embraced this public benefit requirement.\(^48\) While there have been various attempts to assert a different, usually narrower, basis for distinguishing charities from other types of organizations, none of these attempts have gained much traction.\(^49\) The bottom line is therefore that this public benefit aspect of charities has become the defining characteristic separating them from other types of nonprofits.\(^50\) Intuitively, this requirement of providing significant public benefit in order to qualify for the legal benefits charities enjoy makes sense, as it essentially requires that charities provide some positive, although perhaps difficult to quantify, return to the public in exchange for those benefits as opposed to simply offering up the possibility that they may be more efficient in producing certain goods and services. Even with

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48. See Bob Jones Univ. v. United States, 461 U.S. 574, 591 (1983) ("Charitable exemptions are justified on the basis that the exempt entity confers a public benefit . . . ."); Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) (2010) (stipulating that an organization is not a charity "unless it serves a public rather than a private interest"); RESTATEMENT (SECOND) OF TRUSTS § 368 cmt. a (1959) (citing the Preamble to the 1601 Statute of Charitable Uses and stating that "[t]he common element of all charitable purposes is that they are designed to accomplish objects which are beneficial to the community"); GEORGE GLEASON BOGERT & GEORGE TAYLOR BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 321 (rev. 2d ed. 1992) (describing how "social benefit" was the common theme in the Preamble to the 1601 Statute of Charitable Uses); GARETH JONES, HISTORY OF THE LAW OF CHARITY 1532–1827, at 27 (1969) (emphasizing that public benefit was they "key" to the Statute of Charitable Uses); John P. Persons et al., Criteria for Exemption Under Section 501(c)(3), in RESEARCH PAPERS, supra note 39, at 1909, 1909 (tracing the concept of "charity" in IRC § 501(c)(3) to the Preamble). But see Bob Jones Univ., 461 U.S. at 608 (Powell, J., concurring) ("I am unconvinced that the critical question in determining tax-exempt status is whether an individual organization provides a clear ‘public benefit’ as defined by the Court.").

49. See, e.g., KERRY O’HALLORAN, CHARITY LAW AND SOCIAL INCLUSION: AN INTERNATIONAL STUDY 1 (2007) (identifying the alleviation of poverty and the encouragement of social inclusion more generally as being the central mission for charities); Fleischer, supra note 13, at 537 (arguing that a fuller understanding of charitable tax subsidies requires a distributive justice analysis to address the "goodness" of various charities); Shannon Weeks McCormack, Taking the Good with the Bad: Recognizing the Negative Externalities Created by Charities and Their Implications for the Charitable Deduction, 52 ARIZ. L. REV. 977, 1025–26 (2010) (proposing that organizations that produce positive externalities should only qualify as charities if they also do not produce serious negative externalities, such as those caused by exclusion policies and the promotion of opposing viewpoints on issues upon which there is reasonable disagreement); Rob Reich, Philanthropy and Its Uneasy Relation to Equality, in TAKING PHILANTHROPY SERIOUSLY: BEYOND NOBLE INTENTIONS TO RESPONSIBLE GIVING 27, 28–29 (William Damon & Susan Verducci eds., 2006) (proposing that philanthropy may, in fact, worsen inequality, but that charities should not worsen social inequalities and should encourage greater equality).

50. See Dana Brakman Reiser, Charity Law's Essentials, 86 NOTRE DAME L. REV. 1, 7–13 (2011) (concluding that an other-regarding orientation is an essential legal characteristic of charities that distinguishes them from other types of organizations).
this requirement, however, we are still left with the difficult task of defining "public benefit." Currently, federal tax law provides only a broad and vague definition.\(^5\) The next Part explores why such a definition reflects a necessary balancing of the two aspects of the role of charities—providing significant public benefit yet at the same time escaping the limitations that the other sectors and mutual benefit nonprofits face.

II. AUTONOMY: A NEW PERSPECTIVE

Even though the nonprofit sector is often referred to as the "independent" sector, it has always been subject to a variety of influences.\(^5\)\(^2\) For example, historically many nonprofit organizations, including charities, have had close financial and other ties to governments, although they have often struggled with the conditions that come with those ties.\(^5\)\(^3\) Similarly, most charities rely on the market as the primary source of the goods and services that they use, and many charities rely heavily on fees paid by consumers, borrowed funds from lenders, and contributions from wealthy donors. The question is therefore not one of absolute independence from governments, market actors, and other groups and private individuals—something charities do not now enjoy and have never enjoyed. Instead, the question is as follows: In what specific respects

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51. See infra Part II.A.1 (discussing the laws that limit charitable purposes).


53. See, e.g., Legal Servs. Corp. v. Velazquez, 531 U.S. 533, 549–50 (2001) (discussing a successful challenge to federal rules prohibiting recipients of certain federal funds from attacking the constitutionality of welfare laws, even if they used nonfederal funds to support such attacks); Rust v. Sullivan, 500 U.S. 173, 196–97 (1991) (discussing an unsuccessful challenge to federal regulations requiring recipients of certain federal funds to avoid abortion-related activities unless such activities were carried on in separate facilities, by separate personnel, supported by nonfederal funds); Trs. of Dartmouth Coll. v. Woodward, 17 U.S. 518, 558–74 (1819) (discussing a successful challenge to what was effectively an attempted state legislative takeover of Dartmouth College); Mark D. McGarvie, The Dartmouth College Case and the Legal Design of Civil Society, in CHARITY, PHILANTHROPY, AND CIVILITY IN AMERICAN HISTORY 91, 91 (Lawrence J. Freidman & Mark D. McGarvie eds., 2003) (relating the Governor of New Hampshire's efforts to secularize Dartmouth College and discussing the transitory role of American churches in public service); Amy E. Moody, Conditional Federal Grants: Can the Government Undercut Lobbying by Nonprofits Through Conditions Placed on Federal Grants?, 24 B.C. ENVT'L AFF. L. REV. 113, 137–48 (1996) (discussing the effects and implications of the Simpson Amendment and versions I and II of the Istook Amendments on the distribution of federal funds to nonprofits).
do charities need to be autonomous from these external influences in order to fulfill their identified role in society?

"Autonomy," as that term is used here, refers primarily to what is commonly identified as negative liberty—that is, freedom from external interference. The reason for focusing on negative liberty is that even absent the legal benefits provided to charities, sufficient government support in the form of available legal forms and other legal rules exists for current-day charities to persist, albeit with lowered financial support and so probably reduced numbers and activities. The existing legal benefits that charities enjoy but other nonprofits do not enjoy are therefore not necessary for charities either to exist or to exercise choice with respect to their activities. Nor is there serious debate (at least in the United States) about the general right of individuals to form voluntary associations with the ability to make charitable choices, although such debates have arisen in certain limited contexts. At the same time, as the following discussion will make clear, charities require some level of interdependence with other groups and individuals to be able to exercise such choices. The key issue raised by this new autonomy perspective for examining the legal rules governing charities is therefore the balance of autonomy versus dependence that best fits the societal role of charities (i.e., the appropriate limits of charity autonomy).

This justification for charity autonomy does not rest on an assertion that either nonprofits generally or charities particularly should be viewed as separate "sovereigns" or otherwise have an

54. See Richard H. Fallon, Jr., Two Senses of Autonomy, 46 STAN. L. REV. 875, 880-81 (1994) (asserting that one associates autonomy with negative liberty or positive liberty and that negative libertarians assume adults have the capacity to lead autonomous lives and do so in the absence of extraordinary interferences). I am therefore not focusing on positive liberty, that is, what government can or should do to empower individuals—or, in this case, institutions—to make choices. See id. at 883-84. (discussing positive libertarian conceptions of liberty and how these conceptions of autonomy emphasize that autonomy requires self-awareness, self-control, and self-governance).

55. See Christian Legal Soc. v. Martinez, 130 S. Ct. 2971, 2978 (2010) (concluding that a public university may condition official recognition for a student group on that group not discriminating in choosing its leadership); N.Y. State Club Ass'n v. City of New York, 487 U.S. 1, 11-12 (1988) (concluding that given the characteristics of the private clubs and associations at issue, the Constitution permitted a state to prohibit certain types of discrimination by such organizations); see also Bob Jones Univ. v. United States, 461 U.S. 574, 603-04 (1983) (concluding that the government's interest in eradicating racial discrimination in education outweighed the free-exercise-of-religion burden imposed on racially discriminatory religious schools by the denial of charity status for such schools).

56. See Brett G. Scharffs, The Autonomy of Church and State, 2004 BYU L. REV. 1217, 1253-58 (describing an "inter-independence" conception of autonomy that walks a middle road between complete independence from outside influences and complete immersion in a web of such influences).
intrinsic right to be left alone, particularly by the government.\textsuperscript{57} Nor does this justification rest on an asserted constitutional right of charities to autonomy, which would not be supported by existing case law under any conditions.\textsuperscript{58} Whatever strength these other justifications may have, the justification relied upon here is this: because the reason for providing extensive benefits to charities is their two-fold role as actors distinct from governments, markets, families, and mutual benefit nonprofits and as providers of public benefit, however defined, a certain measure of autonomy is required. Without the autonomy described in this Part, including autonomy from government regulation, charities would in fact have a significantly weaker case for claiming those benefits because they would lose their distinctive, subsidy-deserving role.

Returning to the four-sector model, considerations of autonomy can be divided by the influence of the actors in the four sectors: government entities and officials; other actors in the nonprofit sector, including beneficiaries, donors, and mutual benefit nonprofit organizations; families; and market actors, including capital investors, lenders, sellers of goods and services, and, finally, purchasers of goods and services. This Part briefly summarizes the current laws with respect to each of these groups and then analyzes these laws from this new autonomy perspective to determine if the existing legal rules are in fact adequately protecting charity autonomy. This analysis reveals that, for the most part, existing laws respect this need for autonomy by limiting or even barring the influence of such groups, but only to the extent needed to prevent these groups from undermining the two fundamental characteristics of charities. It also reveals, however, one major weakness (as well as several more minor flaws) in current laws

\textsuperscript{57} See Evelyn Brody, Of Sovereignty and Subsidy: Conceptualizing the Charity Tax Exemption, 23 J. CORP. L. 585, 588–89 (1998) (exploring whether current law inherently reflects a sovereign view of charity); Zelinsky, supra note 30, at 806–07 (exploring whether the constitutionality of extending benefits to religious institutions is dependent upon the extension of benefits to secular organizations); see also Lael Daniel Weinberger, The Business Judgment Rule and Sphere Sovereignty, 27 T.M. COOLEY L. REV. 279, 281–82 (2010) (applying the concept of sphere sovereignty as a paradigm for understanding why the business judgment rule exists).

that should be remedied to ensure the proper degree of charity autonomy.

A. Autonomy with Respect to Governments

Government entities and officials interact with charities in three general ways: (1) general regulation of charities tied to the provision of the legal benefits previously described; (2) advocacy, lobbying, and election-related activities by charities to influence government policy and personnel; and (3) government funding of charities. While other forms of interaction exist, such as funding of government entities by charities and collaborations between charities and governments, these other ways either pose little risk of government influence over charities (in the case of a charity funding a government entity) or represent a variation on one of these three general categories. This Section first discusses the laws that limit charitable purposes and therefore activities, as opposed to laws that limit the influence of other private parties, which will be discussed in later sections. It then discusses the relative lack of government regulation relating to the internal affairs of charities; the limits on advocacy, lobbying, and election-related activities of charities; and, finally, government funding of charities.

1. Limits on Permitted Purposes

The most obvious way that government entities and officials influence the activities of charities under current law is by limiting the purposes that charities may further. The starting place for these limits is the definition found in the federal tax law section granting charities exemption from income tax. This definition, which follows, is also mirrored in other tax provisions benefitting charities:

Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals . . . .

59. For example, collaboration usually means sharing government resources with a charity (i.e., a form of government funding) or working together to form government policy (i.e., a form of advocacy or lobbying).

60. I.R.C. § 501(c)(3) (2006); see also id. § 170(c)(2)(B) (relating to the deductibility of contributions for income tax purposes); id. § 2055(a)(2) (relating to the exclusion of such contributions from taxable estates); id. § 2522(a)(2) (relating to the exclusion of such contributions from taxable gifts).
A broad range of purposes fall within these statutory terms, particularly "charitable," "educational," and "religious." The limits on such purposes are few and consist of prohibitions on promoting illegal activity, acting contrary to clearly established public policy, and, in the education context, promoting irrational and unsupported (even by coherent argument) views.

Consistent with an autonomy perspective, the justification for the breadth of the definitions and the few limits that exist is found in the dual role of charities previously identified in this Article. All the theories explaining the existence of nonprofits generally and charities more specifically focus on the distinctive nature of nonprofits as compared to other types of entities and so focus on a nonprofit organization's ability to avoid the weaknesses of those other entities. What all of these theories—and academics and policymakers trying to apply them—have difficulty doing, however, is concretely identifying what specific goods, services, or activities are best done by charities.

61. See Treas. Reg. § 1.501(c)(3)-1(d)(2) (2010) (defining "charitable" to include not only relieving "the poor and distressed or . . . the underprivileged" but also combating community deterioration and juvenile delinquency, defending human and civil rights, eliminating prejudice and discrimination, erecting or maintaining public buildings or works, and lessening the burdens of government more generally, as well as "advanc[ing]" education, religion, or science); id. § 1.501(c)(3)-1(d)(3)(i)(a), (b) (defining "educational" to include not only schooling in a formal institution but also more broadly "instruction or training of the individual for the purpose of improving or developing his capabilities," and "instruction of the public on subjects useful to the individual and beneficial to the community"); INTERNAL REVENUE SERV., TAX GUIDE FOR CHURCHES AND RELIGIOUS ORGANIZATIONS 27 (2009), available at http://www.irs.gov/pub/irs-pdf/p1828.pdf ("The IRS makes no attempt to evaluate the content of whatever doctrine a particular organization claims is religious, provided the particular beliefs of the organization are truly and sincerely held by those professing them.").

62. See Bob Jones Univ. v. United States, 461 U.S. 574, 591 (1983) (denying tax-exempt status for a racially discriminatory admissions policy because the university was acting contrary to clearly established public policy); Nat'l Alliance v. United States, 710 F.2d 868, 873–74 (D.C. Cir. 1983) (upholding denial of charity status because of the organization's failure to provide a sufficiently full and fair exposition of the pertinent facts in its "educational" material); Nationalist Movement v. Comm'r, 102 T.C. 558, 591–94 (1994) (applying the test contained in Revenue Procedure to conclude that petitioner's newsletter was not in furtherance of an educational purpose), aff'd on other grounds, 37 F.3d 216 (5th Cir. 1994); Treas. Reg. § 1.501(c)(3)-1(d)(3)(i) (2010) (requiring a sufficiently full and fair exposition of the pertinent facts to qualify as "educational"); Rev. Proc. 86-43, 1986-2 C.B. 729 (outlining criteria used by the Internal Revenue Service to determine the circumstances under which an organization is considered "educational"); Rev. Rul. 75-384, 1975-2 C.B. 204 (denying tax-exempt status to organizations that promote illegal activity).

63. As previously noted, these weaknesses include the inability to overcome significant free-riding issues, contract failure, political-will failure, bureaucratic failure, and/or membership failure. See supra Part I.B.

64. See, e.g., Richard Schmalbeck, Reforming Uneven Subsidies in the Charitable Sector, 66 EXEMPT ORG. TAX REV. 237, 237–38 (2010) (acknowledging the difficulty of comparing the relative worthiness of existing charitable purposes).
The government-failure economic theories identify nonprofits as entities able to avoid a lack of majoritarian (or sufficiently coherent and influential minoritarian) will, the bureaucratization that is usually inherent in government activities, and the legal constraints faced by the government. The difficulty of the government itself identifying and limiting charities to politically chosen activities, as opposed to activities chosen by charity entrepreneurs, donors, and consumers, is self-evident—although Brian Galle has argued that this problem is overstated. The limited ability of government to dictate what a charity may do in the areas where government itself is constrained, particularly with respect to religious activities, is also fairly obvious. As for the activities beset by bureaucratization, there is evidence that the government can and does tend to crowd charities out of areas when it determines that, even with its bureaucratic limitations, it is the best direct provider of certain goods or services. However, by giving charities the freedom to still operate in these areas, most prominently in education, that determination is subject to constant testing to ensure it is correct, thereby avoiding the political will failure potential.

The market-failure economic theories identify nonprofits as entities able to overcome significant free-rider issues by attracting gratuitous support from donors and volunteers. They also identify nonprofits as able to overcome contract failure issues because donors and consumers perceive nonprofits as providing difficult-to-evaluate goods and services more reliably than profit-seeking entities. Yet scholars have found it difficult to identify what specific types of activities fall into each of these categories at any given moment. Moreover, the list of these activities almost certainly changes over time as new ways of preventing free riding and evaluating the quality of goods and services emerge. For example, while public television and

65. See supra note 15 and accompanying text.
66. See Galle, supra note 15, at 37–38 (arguing that government is more “reflective of contemporary preferences than is [private] charity, is better able to deliberate between competing goals, and in general is no less capable of enacting them”).
67. See Jonathan Gruber & Daniel Hungerman, Faith-Based Charity and Crowd Out During the Great Depression, 91 J. PUB. ECON. 1043, 1045 (2007) (study suggesting that New Deal spending resulted in a thirty percent reduction in church spending on social services). But see Richard Steinberg, Does Government Spending Crowd Out Donations?, 62 ANNALS PUB. & CO-OPERATIVE ECON. 591, 604 (1991) (concluding that no clear pattern is discernable in crowding out studies involving different goods and services); infra note 99 (citing studies indicating that government funding of nonprofits has no clear effect on private donations).
68. See, e.g., COLOMBO & HALL, supra note 13, at 108–09 (proposing a donative-theory approach to resolve this problem); Fleischer, supra note 13, at 531; Hansmann, supra note 16, at 862–68 (considering various types of complex personal services).
radio used to be the classic examples of significant free riding, the emergence of pay television and radio appears to have changed that categorization. At the same time, there is an ongoing debate regarding whether readily available free news makes journalistic outlets, particularly newspapers, increasingly subject to a free-rider problem such that they should now be able to qualify as charities.\textsuperscript{69} Similarly, it is arguable that the growing availability of consumer-orientated information about the quality of health care, as well as the role of insurance companies in screening health care providers, sufficiently informs even single-use consumers so that they can determine which providers give the best care. Both of these factors suggest that any attempt by the government to specifically limit the activities of charities based on these theories would be ill-advised, even assuming concerns about the political process (addressed below) are negligible. If it is difficult to identify activities that truly generate substantial, difficult-to-capture externalities (i.e., public benefit), then it may make more sense to leave such identification to donors, volunteers, and charity entrepreneurs that pursue such activities as opposed to the government.\textsuperscript{70} Furthermore, if such activities change over time it may be best not to codify a specific list of such activities, even if it could be done accurately at a given moment in time, and risk such restrictions quickly becoming obsolete.

The political theories justifying the existence of and support of nonprofits—particularly charities—inherently require that the individual citizens who found, manage, and support those charities (instead of the government) determine what activities to pursue.\textsuperscript{71} The strength of such theories might be relatively low with respect to charities that primarily or exclusively provide goods or services. But for charities concerned with public policy research and advocacy, having the government limit the subjects considered and the viewpoints asserted in the interest of ensuring "public benefit" would

\textsuperscript{69} See, e.g., Marion R. Fremont-Smith, Can Nonprofits Save Journalism? Legal Constraints and Opportunities, 65 EXEMPT ORG. TAX REV. 463 (2010) (arguing that newspaper publishing is now unprofitable and thus should be granted nonprofit status); Richard Schmalbeck, Financing the American Newspaper in the Twenty-first Century, 35 VT. L. REV. 251, 251 (2010) (arguing that the declining circulation and advertising revenue can be solved by changing the financial structure of journalistic output); Nick Gamse, Note, Legal Remedies for Saving Public Interest Journalism in America, 105 NW. U. L. REV. 329, 359 (2011) (arguing that a nonprofit tax subsidy would ensure that newspapers survive in the new economy).

\textsuperscript{70} See Evelyn Brody, Institutional Dissonance in the Nonprofit Sector, 41 VILL. L. REV. 433, 463–64 (1996) ("Many activities have, in various times and various places, been provided within various spheres of conduct: the family, the church, the government, the proprietary sector and private community organizations.").

\textsuperscript{71} See supra note 23 and accompanying text.
defy the rationale of these theories. Such government action would also possibly be constitutionally suspect. Indeed, these theories explicitly or implicitly assume that a broad range of viewpoints itself provides a public benefit. Similarly, the supply-side theories relating to altruism and social entrepreneurs also rest heavily on charity activities being set by the individual participants and not the political process.\textsuperscript{72}

Does that mean that there is no justification for even the existing broad and vague limitations found in federal tax law and most state law counterparts? The answer is no for at least three reasons. First, certain purposes, such as promoting illegal activity, clearly cause significant public harm and so are antithetical to providing public benefit under any plausible definition of that term.\textsuperscript{73} Such identified public harm purposes (and activities) are currently strictly limited, however. While there have been various proposals to impose broader limits based on this rationale, doing so would once again raise the specter of eliminating one of the primary distinctions charities enjoy vis-à-vis government.\textsuperscript{74}

Second, just because more refined limitations are difficult if not impossible to identify does not mean that the existing limitations are without merit. The current limitations have the weight of history behind them—dating from the seventeenth century, if not earlier—and existing empirical data to support the view that they are compatible with the role of nonprofits, and particularly charities, in society. For example, despite the much-reported move of for-profit entities into traditionally charitable areas, such as hospital care and education, the reality is that the vast majority of hospital beds (seventy percent) and, among private providers of higher education, students (sixty percent) are still found within nonprofits.\textsuperscript{75}

\textsuperscript{72} See supra note 27 and accompanying text.

\textsuperscript{73} See supra note 62 and accompanying text.

\textsuperscript{74} See, e.g., McCormack, supra note 49; Nicholas A. Mirkay, Is It "Charitable" to Discriminate? The Necessary Transformation of Section 501(c)(3) into the Gold Standard for Charities, 2007 Wis. L. Rev. 45, 105–06 (arguing that a broader definition of “charitable” is necessary to prevent discriminatory practices in charitable organizations).

\textsuperscript{75} See Kaiser Family Found., Trends and Indicators in the Changing Health Care Marketplace ex. 5.4 (2005), available at http://www.kff.org/insurance/7031/print-sec5.cfm (showing that not-for-profit ownership of community hospital beds remained between sixty-nine percent and seventy-one percent from 1980 through 2003); Nat’l Ctr. For Educ. Stat., U.S. Dept’T of Educ., Digest of Education Statistics 2009, at 279 (2010) (showing an increasing percentage of higher education students attending for-profit institutions from fall 1967 through fall 2008, although absolute enrollment at not-for-profit higher education institutions also increased significantly during this period); see also Mark Schlesinger & Bradford H. Gray, Nonprofit Organizations and Health Care: Some Paradoxes of Persistent Scrutiny, in The
Interestingly, it also appears that if a particular area—for example, hospitals in particular markets or student loans more generally—no longer has sufficient market-failure problems to prevent for-profit businesses from entering, investors appear to move successfully into that area and displace charities, although not always without negative consequences. Similarly, the government may be able to occupy roles previously held by charities if it overcomes its political will and bureaucratic limitations and then chooses to fulfill those roles directly (as opposed to through merely providing funding to existing nonprofits). While neither mechanism is perfect, and more research needs to be done regarding how and to what extent governments and businesses effectively police these boundaries by entering or abandoning various areas of activity, the existing data suggest that both the market sector and the public sector may be capable of realigning the boundaries of the charitable sector without explicit legal changes to those boundaries.

Third and most importantly, certain purposes may provide only incidental benefit to the larger community as opposed to providing benefits to market-rate-paying consumers. While exactly which purposes have “non-incidental” public benefit is a subject of much debate, a couple of examples illustrate how the law currently draws this line. As noted previously, there would appear to be as strong an argument for contract failure with respect to the provision of legal services as there is for other hard-to-judge services, such as education. Yet, providing the former is not considered an inherently charitable activity while providing the latter is, apparently because of the perception (whether correct or not) that the latter provides a more-

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76. See, e.g., Guy David, The Convergence Between For-profit and Nonprofit Hospitals in the United States, 9 INT'L J. HEALTH CARE FIN. ECON. 403, 408-09 (2009) (suggesting that hospitals may effectively choose between nonprofit and for-profit status depending on the changing economic and regulatory environment in which they operate); Eric C. Hallstrom, Note, Here We Go Again—The Conversion of Qualified Scholarship Funding Corporations from Nonprofit to For-profit Status, 25 J. CORP. L. 659, 665-67 (2000) (describing the transfer of student loan activities from charities to for-profits); see also John H. Goddeeris & Burton A. Weisbrod, Conversion From Nonprofit to For-profit Legal Status: Why Does It Happen and Should Anyone Care?, in To Profit or Not to Profit: The Commercial Transformation of the Nonprofit Sector 129, 130-31 (Burton A. Weisbrod ed., 1998) (describing the transfer of health-maintenance and health-insurance activities from nonprofit, but not necessarily charitable, organizations to for-profit entities).

77. See supra note 67 and accompanying text.

than-incidental public benefit in addition to benefitting the fee-paying consumers.\textsuperscript{79} While the provision of legal services \textit{may} qualify as charitable, it only does so either when provided to those who otherwise could not afford such services—legal aid—or when structured to pursue a primarily public, not a primarily private, interest.\textsuperscript{80}

A similar comparison exists between providing health insurance, providing health services to a closed, fee-paying group, and providing health care to the community more generally. For the first category, Congress has flatly stated that providing insurance generally is not considered a charitable activity.\textsuperscript{81} For the second category, the Internal Revenue Service ("IRS") has successfully argued in court that providing health services only to members who are able to pay—the typical health maintenance organization ("HMO") model—will not be considered charitable without some type of public-benefitting "plus," although the position of the IRS (and the courts) is somewhat unclear because these situations also involved entities that did not themselves directly provide health care services.\textsuperscript{82} The Treasury Department has separated out the last category by requiring direct health care providers to have certain "community benefit" characteristics in order to qualify as charities. These requirements are primarily designed to provide access to everyone in the community who can pay (including through Medicare and Medicaid) and emergency care to everyone in the community regardless of their ability to pay. They also prevent certain private actors (i.e., physician groups) from obtaining prohibited private benefit for themselves.\textsuperscript{83} While arguments can be made that any economic activity provides incidental community benefits, given the substantial legal benefits that charities enjoy, it is reasonable to require them to provide more

\textsuperscript{79} See \textit{supra} note 17.
\textsuperscript{80} See Rev. Proc. 92-59, 1992-2 C.B. 411 (establishing procedures for public interest law firms wishing to accept fees and continue to qualify as charitable); Rev. Rul. 75-74, 1975-1 C.B. 152 (stating that a public interest law firm can qualify as charitable); Rev. Rul. 69-161, 1969-1 C.B. 149 (stating that providing free legal services to persons otherwise financially incapable of obtaining such services is charitable), \textit{amplified} by Rev. Rul. 78-428, 1978-2 C.B. 177 (permitting fees to be charged if based only on ability to pay).
\textsuperscript{81} I.R.C. § 501(m) (2010) (denying charity status to organizations for which providing commercial-type insurance is a substantial part of their activities).
\textsuperscript{82} See IHC Health Plans Inc. v. Comm'r, 325 F.3d 1188, 1202-03 (10th Cir. 2003) (concluding that organizations promoting health by providing health insurance to all in the community who are able to pay do not qualify as charities absent the provision of additional community or public benefits); Geisinger Health Plan v. Comm'r, 30 F.3d 494, 501-02 (3d Cir. 1994) (same).
than incidental public benefit, which is what federal tax law currently does.

Overall, therefore, the current federal tax law limits on the purposes charities can further appear relatively well calibrated to not unduly limit charities while at the same time to ensure that they are in some way furthering a public benefit, thereby distinguishing them from other private entities, including mutual benefit nonprofits. Debates on the margins—with respect to the provision of health care most recently but also with respect to the breadth of "educational"—certainly exist and are important, but even then the debates usually fit within this framework. That is, keeping the listed purposes broadly and vaguely defined in most instances is an important aspect of achieving the level of autonomy that best matches the unique role of charities.84

2. Lack of General Limits on Internal Affairs

While the list of purposes charities must pursue may be relatively broad and vaguely defined, current federal and state laws are even more permissive with respect to regulating how charities organize their internal affairs, including specific legal form, governance structures, and methods charities use for accomplishing their activities.85 For example, charities can choose among a variety of legal forms—nonprofit corporation, trust, unincorporated association, even limited liability company—and face few restrictions on the numbers and compositions of their governing bodies.86 That being said, it is not uncommon for Congress or the Treasury Department to impose governance or other internal affairs limitations on particular types of charities. For example, for hospitals, the Treasury Department has long required a governing body that is representative of the community—as opposed to consisting of only physicians or

84. But see Roger Colinvaux, Charity in the 21st Century: Trending Toward Decay, 11 FLA. TAX REV. 1, 67 (2011) (suggesting that more effective enforcement of the existing limitations might require brighter lines and, perhaps, more positive requirements).


86. See, e.g., Rev. Rul. 66-219, 1966-2 C.B. 208 (ruling that an otherwise-qualified charity will not be precluded from that status under federal tax law solely because a single individual is its sole trustee). But see CAL. CORP. CODE § 5227 (West 2010) (requiring California nonprofit corporations to have a governing body majority that is not compensated by the corporation for services other than as a director); INTERNAL REVENUE SERVICE, GOVERNANCE AND RELATED TOPICS—501(C)(3) ORGANIZATIONS 2–3 (2008), available at http://www.irs.gov/pub/irs-tege/governance_practices.pdf (urging charities to avoid very small governing boards).
members of a single family—and an open medical staff. The general hands-off approach to the internal affairs of charities is consistent with an autonomy perspective.

As importantly, all of the instances where the federal government has imposed specific limitations on charity governance activities share two key characteristics. First, the instances were all reactions to evidence of significant violations of the nondistribution and private benefit restrictions by the type of charity targeted. For example, with respect to hospitals, the identified and targeted abuse was groups of physicians operating purportedly charitable hospitals primarily for their own benefit as opposed to for the benefit of the larger community. Second, each set of limitations represents an indirect attempt to ensure protection of the fundamental public benefit character of the charity type at issue. Rather than attempting to require charities to engage in specific activities, for the most part Congress and the Treasury Department have instead tried to establish conditions that create a more favorable environment for generating public benefit without mandating how, specifically, that public benefit should be achieved. For example, neither Congress nor the Treasury Department has dictated the mix of medical services that a charity hospital must provide or even the amount of free care such an entity must render. Even Congress's most recent attempts to control the activities of charity hospitals, enacted as part of health care reform, have primarily been limited to enhanced public benefit disclosure and improved fee-collection procedures, as opposed to directed substantive activities. For the reasons already discussed, this indirect approach to address specific, identified violations of the fundamental public benefit character of charities is consistent with preserving charity autonomy from government influence except when that character is clearly threatened.

87. See Rev. Rul. 69-545, 1969-2 C.B. 117 (including these requirements as part of what has come to be known as the "community benefit" standard); I.R.S. Priv. Ltr. Rul. 2009-47-064 (Nov. 20, 2009) (applying this standard).

88. See Douglas Mancino, Income Tax Exemption of the Contemporary Nonprofit Hospital, 32 ST. LOUIS U. L.J. 1015, 1053 (1988) (noting that medical boards run by one physician or a small group of physicians are more likely to be viewed as being self-interested).

89. See Colinvaux, supra note 84, at 51 ("Instead of imposing a substantive positive requirement of charity, the [health care reform] legislation settles instead for process-oriented rules that are designed to promote a more charitable outcome."). Compare S. FIN. COMM., 111th Cong., DESCRIPTION OF POLICY OPTIONS: FINANCING COMPREHENSIVE HEALTH CARE REFORM 33–34 (2009) (discussing the possibility of requiring charity hospitals to provide a minimum level of charitable patient care), with Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 9007(a), 124 Stat. 119, 855–57 (2010) (codified at I.R.C. § 501(r) (Supp. IV 2010)) (imposing new requirements on charity hospitals but not including a minimum level of charitable patient care).
3. Limits on Interactions with Government Entities and Officials

In contrast to the general lack of limits on internal affairs and methods for achieving permitted purposes, current federal tax laws impose specific limitations on the ability of charities to interact with government entities, officials, and want-to-be officials (i.e., candidates). Congress has explicitly limited the permitted amount of lobbying by a charity and has absolutely prohibited charities from supporting or opposing candidates for election to public office. The reasons for these restrictions are obscure. That said, they have stood the test of time and appear to be generally consistent with public perceptions of the permitted scope for activities of charities. Are they, however, consistent with the autonomy and public benefit characteristics of charities, as developed above?

Turning first to the prohibition on supporting or opposing candidates, there are two reasons to conclude that the answer to this question is yes. First, supporting a specific candidate (or opposing her electoral adversary) arguably provides a nonincidental private benefit to that candidate, contrary to the public benefit character of charities. While it could be argued that by supporting or opposing candidates a charity is promoting informed participation in elections and so is also providing a public benefit, charities can avoid private benefit and still promote informed electoral participation simply by engaging in even-handed electoral activities that do not favor one candidate over another.

Second, permitting charities to support or oppose particular candidates would invite candidates, political parties, and their supporters to pressure charities to support them. Such pressures...
already exist to a limited degree, even with the prohibition in place, but the existence of the prohibition provides charities with a ready and convincing response to such pressures: you are asking us to break the law. The prohibition therefore serves to protect the autonomy of charities from elected government officials.

The lobbying limitation is more problematic. It is not clear that lobbying either necessarily involves providing a private benefit or exposes charities to undue influence from government officials. The original proponents of the limit on lobbying were primarily concerned with the public benefit issue. Even they recognized, however, that, as drafted, the limit is overinclusive as it also covers lobbying that is not tainted by private benefit; the only reason that they apparently did not draft a narrower provision was because they could not determine how to do so. It is also not clear why the now-existing private benefit limitation—provided in regulations and other authority issued after passage of the statutory limit on lobbying and described below—is not sufficient to address this concern.

With respect to undue influence, if anything, the lobbying limit appears to be aimed at preventing charities from unduly influencing government, not the other way around. While the current scope of the limit does not completely match that objective, nevertheless there is little evidence that charities are at risk of being co-opted by government officials to engage in lobbying efforts that are inconsistent with the missions of the charities. It therefore appears that there is little justification for limiting the autonomy of charities by restricting their lobbying activities.

4. Government Funding

There are no legal restrictions on charities seeking or receiving government funds, and government funders often exercise substantial influence over charities by imposing conditions on the funds they provide. Government funding in this context refers to funds that the government gives to charities to perform certain government-selected activities that benefit the public. An example of such funding would be when governments select social service providers, such as foster care agencies, to serve those that the government has decided to benefit. Such government funding therefore does not include government

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94. See Houck, supra note 91, at 16–23; Mayer, supra note 90, at 500 & n.53.

95. See Mayer, supra note 90, at 500 & n.55.
funds that flow to charities selected by the beneficiaries of those funds who receive goods or services that benefit them personally in return (e.g., when a Medicare recipient chooses to visit a particular charity hospital for medical care or when a parent uses a voucher to pay for her child’s tuition at the charity school of her choice). Nor does it include government funds paid to charities as fair-market-value payment for goods or services provided directly to the government. In these situations, the beneficiary or the government is a purchaser of goods or services for its own benefit, a context addressed later in this Part. There will be situations that do not fall neatly on one side or other of this line, but that is not critical for purposes of this discussion.

The influence governments exercise through providing funding for activities that benefit the public does not raise the same risk of diversion from public benefit that influence by private entities raises for the simple reason that the government itself is dedicated generally to providing public, not private, benefit. But government influence, whether through providing funding or otherwise, can raise concerns about whether a particular charity is in fact helping solve government and market failures (and promoting pluralism) since the charity is effectively furthering the government’s particular view of public benefit. This point has led to disputes in some instances between recipients of government funds and governments.

Even if a charity is so dependent on government funding and resulting government influence that it might fairly be characterized as an arm of the government, such characterization should not disqualify the charity from any of the legal benefits it customarily enjoys. This is because government entities enjoy very similar legal benefits, including exemption from most if not all taxes, the ability to receive deductible charitable contributions (as long as the government uses such contributions for a public purpose), and most if not all of the other exemptions and benefits that charities enjoy. So while a lack of


98. See I.R.C. § 103 (2010) (excluding interest on any state or local bond from federal income taxation); id. § 115 (excluding state and local government income from federal income taxation); id. § 170(c)(2) (including within the definition of a deductible charitable contribution a contribution to a domestic government if exclusively for public purposes); CHARLES A. TROST & PAUL J. HARTMAN, FEDERAL LIMITATIONS ON STATE AND LOCAL TAXATION § 6.19 (2d ed. 2003)
autonomy from the government may raise other concerns for charities, not the least of which is prioritizing efficiency in the delivery of the services desired by the government over providing a broader community benefit, it should not affect the eligibility of a charity for its otherwise-available legal benefits since there is no indication that government influence generally results in diversion from public benefit goals.99

There is also no need for a new legal barrier to government funding of charities in most instances for the simple reason that charities already generally have the right to refuse to participate in government programs. Government funding is therefore distinct from government regulation, which would require all charities (or charities of a particular type) to conform to that regulation. While perhaps charities were once naïve enough to not realize that government funding could come with significant strings, the many conflicts between government funders and charities have undoubtedly eliminated such illusions for the vast majority of charity leaders.100 It may be difficult to do some kinds of activities, such as engaging in scientific research and providing certain social services, without accepting government funds, but that choice still exists. It is also true that government funding of specific activities may reduce private support for those activities and that government performance of those activities directly may also crowd out private actors, including charities, currently engaged in the activities. Such indirect effects on

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99. See Rachel M. McCleary, Global Compassion: Private Voluntary Organizations and U.S. Foreign Policy Since 1939, at 6 (2009) (considering the effect of government funding on private international relief and development organizations); SHERLOCK & GRAVELLE, supra note 11, at 48 (noting that when the government provides funding to charities, as opposed to directly engaging in activities itself, empirical research indicates the government may either crowd out or “crowd in” private funding); Arthur C. Brooks, Do Government Subsidies to Nonprofits Crowd Out Donations or Donors?, 31 PUB. FIN. REV. 166, 175–77 (2003) (concluding that increased public funding of nonprofits does not reduce total donations to nonprofits but does change the mix of donors); Thomas A. Garret & Russell M. Rhine, Government Growth and Private Contributions to Charity, 143 PUB. CHOICE 103, 115–19 (2010) (in the education context, concluding that whether government funding crowds out private donations depends on the source of government revenue, how that revenue is used, and the rational ignorance of the private donors); Michael Rushton & Arthur C. Brooks, Government Funding of Nonprofit Organizations, in Financing Nonprofits: Putting Theory into Practice 69, 88–90 (Dennis R. Young ed., 2007) (discussing concerns raised by government funding of all types).

100. See, e.g., Steven Rathgeb Smith, Government Financing of Nonprofit Activity, in NONPROFITS & GOVERNMENT, supra note 24, at 219, 234–36 (describing such conflicts).
charities appear unavoidable absent a wholesale rollback of government involvement in areas where charities are also active.\textsuperscript{101}

\textbf{B. Autonomy with Respect to Nonprofit Sector Actors}

External influences on charities can also come from within the nonprofit sector, primarily from four groups: management, including governing body members; beneficiaries; donors; and mutual benefit nonprofits. Management will be addressed later in this Part under the prohibition on capital investors, since the primary concern with managers is that they may attempt to siphon off a charity’s net revenues for their personal gain.\textsuperscript{102} This Section will address the other three groups.

1. Beneficiaries

The term “beneficiaries” in the charity context refers to those who benefit gratuitously from a charity’s activities, as distinguished from consumers who pay full fair market value for the goods or services they receive from a charity; the latter will be discussed later in this Part.\textsuperscript{103} Beneficiaries would include, for example, those who receive free meals from soup kitchens, free shelter from homeless shelters, disaster relief from the Red Cross and Salvation Army, free education from a charity school, or free medical care from a charity clinic. Some individuals will be somewhere between a pure beneficiary and a pure consumer, such as a student who receives a partial scholarship. But for the purposes of this Section, it is the one-hundred-percent beneficiary that will be considered.

First and foremost, existing law prevents charities from only serving a limited and well-defined group of beneficiaries by prohibiting “private benefit.”\textsuperscript{104} While at its broadest interpretation “private benefit” would include any benefit to any private individual or

\begin{footnotesize}
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\item \textsuperscript{101} See \textit{supra} notes 77 & 99 and accompanying text (describing the possible “crowding out” effect of government direct activities and funding).
\item \textsuperscript{102} See \textit{infra} Part II.D.1 (describing why charities are prohibited from having owners and the IRS’s and Congress’s attempts to prevent “profit leakage” by penalizing those who receive excessive benefits from charities).
\item \textsuperscript{103} See \textit{infra} Part II.D.4 (highlighting the distinction between activities that are “inherently charitable,” for which charities may charge full market value, and those that are not).
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private organization, that is not how the term is used in this context. As the federal government has recognized, the paying of compensation to a private individual or the purchase of goods from a business confers private benefit, yet charities could not function (i.e., could not provide public benefit) without being able to engage in such activities. More fundamentally, even feeding the hungry or housing the homeless provides a private benefit to the beneficiaries, yet such activities have always been deemed as being consistent with charity status. The government has therefore determined that organizations should not lose their charitable status if the private benefit provided is "incidental," defined in both qualitative and quantitative terms. The qualitative aspect is that the benefit is necessary to further the charity's public-benefit-serving purpose. The quantitative aspect is that the benefit is no more than what is needed to serve that purpose. Examples of such incidental private benefits include paying employees and vendors reasonable (i.e., fair market value) amounts for their services and goods if those services and goods are used to further the charity's purpose and providing services and goods for free or at below-market prices when doing so furthers that purpose, such as providing food or shelter to the poor.

Besides the general private benefit restriction, there are no legal barriers preventing beneficiaries from co-opting a charity to serve their private benefit as opposed to providing a public benefit. The private benefit restriction does, however, include the requirement that a charity serve a "charitable class," loosely defined as a relatively large and indeterminate group of individuals circumscribed by some shared "charitable" characteristic. That requirement is sufficient to create a number of substantial practical barriers to beneficiaries co-opting a charity. First, a group that qualifies as a charitable class is unlikely to be able to engage in conscious concerted action, given its size and indeterminate nature. Second, if any particular subset of that

107. Id.
108. See Am. Campaign Acad. v. Comm'r, 92 T.C. 1053, 1076–77 (1989) (holding that Republican candidates benefiting from the work of the academy's graduates did not constitute a "charitable class"); see also PETER LUXTON, THE LAW OF CHARITIES 171–72 (Judith Hill ed., 2001) (discussing the need for a charity to serve a sufficient section of the community under English law); Colombo, supra note 105, at 1080 (noting that the private benefit doctrine has, as applied by the IRS, expanded well beyond a focus on the size of the charitable class benefited).
group tries to redirect a charity's efforts, the charity's leadership can redirect the charity's benefits to other beneficiaries and potential beneficiaries—a "biting the hand that feeds you" result. Third, the influence of beneficiaries over a charity generally is based on the ability of beneficiaries to call charity leaders publicly to account for failing to provide public benefit; unless the beneficiaries can hide their private benefit under a convincing veneer of public benefit, this lever is not available to redirect a charity away from providing public benefit. Likely for these reasons, there is little if any evidence of beneficiaries—whether soup kitchen patrons or art museum visitors who are not also donors—using their influence to cause a charity to depart from providing public benefit.

2. Donors

Donors are a different story. Because they provide financial support, and sometimes the bulk of financial support, to many charities, they have the potential to use that influence for their own, private benefit. Existing law restrains the ability of donors to influence charities in three specific ways.

The first way targets the situation in which a charity is dependent on a relatively small group of donors. Over forty years ago, the Treasury Department and Congress recognized based on significant evidence that such charities could be and had, in fact, often been used for the private benefit of their donors. For this reason, Congress divided charities into two categories: private foundations and public charities. Unless a charity is engaged in activity that indicates significant public oversight—hospitals, schools, and churches primarily—or has a sufficiently broad base of financial support, it will be classified as a private foundation and subject to a restrictive set of rules primarily targeted at the provision of private benefit.


The second way to restrain donors is through imposing stringent limitations on what donors can receive in return for their deductible contributions and on the extent to which they can control their donated funds or other assets.112

Finally, substantial donors may be considered charity insiders (known as “disqualified persons”) if they exercise substantial influence over a charity, including if they are a voting member of a charity’s governing body.113 As such, they are subject to financial penalties known as “intermediate sanctions” if they receive any excess economic benefits (i.e., benefits that are not part of a fair-market-value exchange and are more than incidental).114

These three sets of rules together provide effective protection against improper donor influence without unduly limiting the autonomy of charities. In situations where a single donor or small group of donors effectively controls a charity, the private foundation rules prohibit certain types of transactions with insiders, including substantial donors; limit business holdings and investments; and prohibit or require certain procedures be followed for certain types of activities.115 Currently, these rules also force private foundations to spend a certain amount on providing public benefit, but even the specific private foundation rules relating to timing arose from concerns that donors were often using the lack of a current spending requirement to receive a private benefit in the form of an immediate charitable contribution deduction without providing any offsetting current public benefit.116 While at least some of the rules were based on relatively thin evidence of abuse, in general they were designed to prohibit violations of the public benefit requirement that neither public pressure nor the IRS had been able to sufficiently prevent.117

The more recent efforts by Congress to place limits on the internal

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113. See I.R.C. § 4958 (2006 & Supp. IV 2010) (imposing a twenty-five percent tax on each “excess benefit transaction” for a disqualified person); Treas. Reg. § 53.4958-3(e)(2)(ii) (2010) (listing being a substantial contributor as one of the facts and circumstances tending to show that a person is having such influence).


115. See I.R.C. § 170(b)(1)(A) (listing the activities where charitable contribution deductions are limited).

116. See Staff of the J. Comm. on Internal Revenue Taxation, General Explanation of the Tax Reform Act of 1969, at 36 (1970) (explaining that prior laws allowed for substantial tax benefits for contributions even if the charity received no current benefit); Troyer, supra note 109, at 12 (explaining how such behavior justified the 1969 Act’s restrictions on self-dealing).

117. See Troyer, supra note 109, at 11–12 (outlining empirical and conceptual grounds for Congress’s special restrictions in the 1969 Act).
activities of supporting organizations and donor-advised funds, including the extension of some of the private foundation rules to these entities, apparently grew out of the congressional view that such entities also suffer from the same problem of significant control by a single or small group of related donors leading to private benefit.\textsuperscript{118}

For other charities, the more general limitations on donors appear sufficient to prevent attempts to divert a charity from providing public benefit. A charity that is not a private foundation necessarily receives at least some measure of public oversight through its beneficiaries, members, or other sources of financial support, hindering the ability of a single substantial donor or small group of substantial donors to influence the charity improperly. The charitable contribution deduction requirement of no significant return benefit also hinders such improper influence since the deduction is often a significant motivation, at least for more substantial donors.\textsuperscript{119} For donors with particularly strong influence, the threat of intermediate sanctions inhibits them from hijacking a charity to benefit their own, private interests. Finally, there is one other factor at play. In part because of all of these limitations, even the largest donors are likely to be significantly motivated by the desire to provide public benefit through the charity. It would be counterproductive for them to prevent the charity from in fact providing such a benefit.\textsuperscript{120} The existing legal rules therefore appear well designed to prevent donors from exercising influence over charities in a manner that would lead charities to abandon providing public benefit, without unduly restricting the autonomy of charities with respect to seeking and receiving donations.

3. Affiliated Mutual Benefit Nonprofits

It is not uncommon for mutual benefit nonprofits, such as unions and trade associations, to have closely affiliated charities. For example, the U.S. Chamber of Commerce is closely affiliated with the


\textsuperscript{119} See CONG. BUDGET OFFICE, EFFECTS OF ALLOWING NONITEMIZERS TO DEDUCT CHARITABLE CONTRIBUTIONS 9–10 (2002) (summarizing research relating to the effect of the deduction on charitable contributions); Brody & Cordes, supra note 34, at 144–47 (same).

\textsuperscript{120} But see TERESE O'DENDAHL, CHARITY BEGINS AT HOME: GENEROSITY AND SELF INTEREST AMONG THE PHILANTHROPIC ELITE 232–34 (1990) (arguing that upper-class donors primarily engage in philanthropy to reproduce the upper class).
National Chamber Foundation, the American Bar Association ("ABA") is affiliated with the American Bar Endowment and the American Bar Foundation, and the American Bankers Association is affiliated with the ABA Education Foundation. Such a close relationship creates the risk that a charity's furtherance of its ostensibly permitted purpose—say public education regarding a particular issue—could be directed in such a way as to benefit the members of the related mutual benefit nonprofit.

It is therefore surprising to see that existing law permits a very close relationship between mutual benefit nonprofits and their charitable affiliates. Both Congress and the IRS have explicitly blessed such arrangements, permitting charities to support certain noncharitable nonprofits and permitting noncharitable nonprofits to form and control a charitable affiliate, respectively. All the activities funded by the affiliated charity must still further one of the purposes permitted for charities (education probably being the most common chosen purpose), and the private benefit and other limitations on charities fully apply. That said, the close relationship with and even control by a mutual benefit nonprofit would likely make it difficult to prevent activities that further the agendas of the mutual benefit nonprofit's members.

There are three reasons, however, why these close relationships are permitted. First, there is a general federal tax law principle that the separateness of distinct legal entities will be respected absent evidence that the separate legal status is a sham, such as a failure to keep the finances of two distinct entities separate. Second, the Supreme Court has made it clear that the Constitution requires the federal government to permit charities to create closely affiliated noncharitable entities to engage in speech-related activities that the charities otherwise cannot engage in, specifically political campaign intervention and substantial


lobbying.\textsuperscript{125} While the constitutional requirement does not flow in the other direction, as a practical matter it would be relatively easy for even an established noncharitable entity to create a charitable affiliate, have all of its members become members of the charitable affiliate with whatever control rights over the affiliate that they previously exercised over the noncharity, and then give the charity control over the noncharity, thereby shifting the direction of control (and so obtaining the constitutional protection) without changing the result. Third and similarly, the board members of a mutual benefit nonprofit could simply create a “nonaffiliated” charity without a formal connection to the noncharity and still engage in (charity) activities that are consistent with the interests and agenda of the noncharity’s members. A simple prohibition on mutual benefit nonprofit control of a charity would therefore almost certainly have little practical effect and a more sophisticated set of rules would be difficult to design, much less implement.

Fortunately, the allowance of these close relationships between mutual benefit nonprofits and charities does not appear to have resulted in improper benefit to the members of the mutual benefit entities. For example, while the National Chamber Foundation’s educational efforts focus, not surprisingly, on research and public education that favors free enterprise in the United States, its efforts appear generic enough to be indistinguishable from those of unaffiliated charities with similar ideological positions, such as the Heritage Foundation or the American Enterprise Institute.\textsuperscript{126} This suggests that either the incentive for a mutual benefit nonprofit to abuse its control is not as strong as might be supposed or the ability of the IRS to enforce the private benefit limitation in this context is greater (or perceived to be greater) than might be expected, or both.\textsuperscript{127} There does not appear therefore to be sufficient evidence to support the creation of special rules to police this set of relationships, at least at this time. These relationships should perhaps, however, be an area

\textsuperscript{125} See Regan v. Taxation with Representation, 461 U.S. 540, 544 n.6, 553–54 (1983) (Blackmun, J., concurring) (allowing a charitable organization to have a lobbying affiliate under I.R.C. § 501(c)); see also Branch Ministries v. Rossotti, 211 F.3d 137, 143 (D.C. Cir. 2000) (citing Regan); Miriam Galston, Campaign Speech and Contextual Analysis, 6 FIRST AMEND. L. REV. 100, 114–17 (2007) (discussing Regan and Rossootti).

\textsuperscript{126} See National Chamber Foundation Programs, NATIONAL CHAMBER FOUNDATION, http://ncf.uschamber.com/programs/ (outlining NCF’s business-related programs).

for future scrutiny by both the government and scholars to determine whether this initial impression is correct.

C. Autonomy with Respect to Families

Existing legal rules generally restrain the interactions of families and charities where there has been significant evidence that families are likely to use their influence over charities for their own, private benefit as opposed to pursuing public benefit. There are at least three ways that family groups may influence a charity to provide them with private benefit and divert the charity from providing public benefit. One way is if a particular family provides the bulk of funding for a charity that is not otherwise easily held accountable by the larger public. Congress designed the private foundation rules discussed above in large part to address this situation, and those rules appear to have been mostly, if not completely, successful.\(^{128}\)

A second way is if a family creates a charity to pursue a mission that primarily benefits that family. For example, a family member might create a charity to engage in genealogical research focused on that person's family. The Treasury Department has generally denied attempts to create a charities with this purpose based on the existing private benefit restriction.\(^{129}\)

A third and more subtle way to gain such influence is for the members of a single family to create an organization that undoubtedly qualifies as a charity under existing law and then to fill the charity's key leadership positions with family members.\(^{130}\) While in theory the same restrictions that in general prevent charity managers from benefitting themselves inappropriately should prevent these family members from receiving inappropriate private benefits, the close relationships of the managers combined with the limited enforcement resources of the IRS and state attorneys general offices might render those restrictions ineffective in the same way that Congress and Treasury found was the case with respect to what are now classified as private foundations. Certainly the IRS and many commentators believe that a charity should, at a minimum, have a governing body with a majority of members who are not related to each other either by

\(^{128}\) Supra notes 115-118 and accompanying text.

\(^{129}\) See Treas. Reg. § 1.501(c)(3)-1(d)(1)(iii), ex. 1 (2008) (listing educational organizations dedicated to studying the history of a single family as an example of organizations that operate for the benefit of private interests and not for public interest as required by I.R.C. § 501(c)(3)).

family or financial ties so as to prevent related managers from inappropriately benefitting themselves.\textsuperscript{131}

Unlike the private foundation situation, however, there does not appear to have been a comprehensive study of charities with these characteristics to determine if such a requirement is necessary. There are certainly examples of family controlled charities that raise private benefit concerns, such as Angel Food Ministries and Oral Roberts University.\textsuperscript{132} That said, there are counterexamples of apparently well-run charities dominated by a particular family, such as the Billy Graham Evangelistic Association.\textsuperscript{133} Moreover, it could be argued that the possible negative examples actually demonstrate that there is no need for such a requirement or other legal restrictions to address this situation because nonfamily members involved in the charity or the media, as was the case with both Angel Food Ministries and Oral Roberts University, will call the charity to account, even if government officials do not.\textsuperscript{134} Family relationships also do not necessarily lead to collusion, as illustrated by the recent public dispute at Feed the Children between, among others, the now former President and his daughter, who serves as the organization's general counsel.\textsuperscript{135} Furthermore, there is little empirical evidence that "independent" governing board members actually improve governance in either the nonprofit context or the for-profit context, as members of the IRS Advisory Committee on Tax Exempt and Government Entities

\textsuperscript{131} See, e.g., \textsc{Internal Revenue Service}, supra note 86, at 3 ("[A] governing board should include independent members and should not be dominated by employees or others who are not, by their very nature, independent individuals because of family or business relationships."); \textsc{Reiser}, supra note 50, at 43 (arguing that group governance can be seriously undermined with related directors).

\textsuperscript{132} See \textsc{April Marciszewski}, \textit{Some Withholding Judgment on ORU}, \textsc{Tulsa World}, Oct. 7, 2007, at A1 (lawsuit filed by former faculty alleging misuse of charity funds by founder's family); \textsc{Christopher Quinn}, \textit{Family Calls Ministry Suit a Money Grab}, \textsc{Atlanta J.-Const.}, Mar. 3, 2009, at 1C (lawsuit by two board members accusing family members who controlled a charity of enriching themselves).

\textsuperscript{133} See, e.g., \textsc{Billy Graham Evangelistic Association, MinistryWatch.com}, \url{http://www.ministrywatch.com/profile/billy-graham.aspx} (detailing a watchdog organization's evaluation). \textsc{But see} \textsc{Billy Graham Evangelistic Association, Better Business Bureau} \url{http://www.bbb.org/charity-reviews/national/billy-graham-evangelistic-association-in-charlotte-nc-1146} (reporting that the charity did not provide requested information).

\textsuperscript{134} See \textsc{Christopher Quinn}, \textit{Agreement Ends Angel Food Case}, \textsc{Atlanta J.-Const.}, June 20, 2009, at 1B (reporting a settlement that required a forensic audit and certain governance improvements); \textsc{Shannon Muchmore}, \textit{ORU Emerging from Crisis}, \textsc{Tulsa World}, Aug. 23, 2008, at A11 (reporting governance changes in the wake of the lawsuit by former faculty).

\textsuperscript{135} See \textsc{Grant Williams}, \textit{Feed the Children Accuses Founder of Taking Bribes}, \textsc{Chron. Philanthropy}, Jan. 14, 2010, at 20 (chronicling Larry Jones's ouster as president and his accusations that his daughter, Feed the Children's vice president and general counsel, was a "key figure in stirring turmoil" at the antipoverty charity).
recently noted. Finally, restrictions on family member involvement with charities not only impose additional administrative burdens on charities, but they also potentially deny them the valuable aid that can come from family members who share a commitment to a particular, worthwhile cause. Lacking further data, there is therefore reason to believe that outside the private foundation context, which Congress has already comprehensively addressed, family influence over charities is sufficiently constrained by the existing legal rules.

D. Autonomy with Respect to Market Actors

The last category of private actors that potentially could pull or push a charity away from providing public benefit, in part or in whole, is those individuals and groups that interact with the charity through the marketplace. As detailed in this Section, one set of these actors is actually foreclosed from such interactions—capital investors (i.e., owners). While there have been recent proposals to relax this restraint, doing so would be inadvisable because of the unjustified reliance of such proposals on effective government enforcement of the public benefit requirement.

Other parties are, however, permitted to interact with charities in the marketplace, including lenders, sellers of goods and services, and purchasers of goods and services. Lenders, however, face significant restraints, both legal and practical, that sufficiently limit their influence (at the cost of reducing charity access to credit). Similarly, sellers of goods and services also face legal and practical restrictions that generally are sufficient to prevent co-opting of charities, except perhaps in the area of fundraising. The one major area that remains almost unregulated, however, is the influence of purchasers of goods and services from charities—specifically, the influence of consumers who purchase services (it almost always is services, not goods), even at fair-market-value prices, in furtherance of permitted purposes for a charity. For reasons detailed below, the existing legal restrictions may be unable to prevent the “invisible hand” of these consumers from pushing charities away from providing public benefit.

1. Capital Investors

Charities are absolutely prohibited from having owners (i.e., capital investors who receive in return for their investment a right to profits and to assets on dissolution and the ability to transfer that right). Federal tax law imposes this limit through the statutory prohibition on private inurement, which is supported by both regulatory requirements and an excise tax imposed on charity insiders who violate the prohibition.\(^\text{137}\) State laws generally impose this limit through statutory nondistribution requirements for nonprofit corporations and common law restrictions on charitable trusts.\(^\text{138}\) The effect of these laws is to prevent a specific group of private parties—owners—from requiring a charity to serve their private interests and, in doing so, diverge from providing a public benefit.\(^\text{139}\)

Even with this restriction, however, there still exists the risk that individuals with sufficient influence over a charity might cause its net revenues to be paid out to them in the form of, for example, excessive compensation. While such an end-run around the private inurement and nondistribution requirement has long been prohibited, in the 1990s Congress enhanced the ability of the IRS to prevent such profit leakage by creating an excise tax regime, known as intermediate sanctions, that penalizes insiders who receive improper economic benefits and managers who knowingly approve such transactions.\(^\text{140}\) Especially with this enhancement, in a world of perfect government enforcement such leakage could therefore be sufficiently addressed, but the reality is that the limited enforcement resources and abilities of both the IRS and state attorneys general has

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not always proven sufficient to answer this call.\textsuperscript{141} Congress and Treasury have therefore developed a number of targeted rules to prevent such profit leakage in situations where it has been found likely to occur even in the face of the existing, general rules.

One such situation is when an organization relies on a small group of related donors for financial support and does not engage in activities that result in significant public scrutiny. As discussed previously, Congress has addressed this situation through the private foundation classification and related rules, which, among other restrictions, bar most financial transactions between such charities and insiders, including substantial contributors.\textsuperscript{142} While the private foundation rules also require enforcement, their bright-line nature facilitates both that enforcement and compliance on the part of private foundation leaders acting in good faith.

Another such situation is the requirement that charity hospitals have a governing body that is representative of the community—as opposed to consisting of only physicians or members of a single family—and an open medical staff.\textsuperscript{143} These restrictions arose from the apparently common situation of a group of physicians opening up a purportedly charity hospital but then restricting its services to their own patients, thereby providing private benefit to that physician group.\textsuperscript{144} More recently, Congress imposed specific governing body and other restrictions on credit counseling organizations in the wake of discovering that many, if not most, of these organizations had been violating the nondistribution constraint and private benefit limitations.\textsuperscript{145} A further example is the limitations

\begin{itemize}
\item \textsuperscript{143} See Rev. Rul. 69-545, 1969-2 C.B. 117 (dictating requirements for charitable hospitals).
\item \textsuperscript{144} See supra note 88 and accompanying text.
\item \textsuperscript{145} See Staff of the J. Comm. on Taxation, Technical Explanation of H.R. 4, The “Pension Protection Act of 2006,” As Passed by the House on July 28, 2006, and as Considered by the Senate on August 3, 2006, at 315–16 (2006) (from 2004 to 2006, the IRS completed audits of section 501(c)(3) credit counseling agencies representing more than forty percent of the revenue in the I.R.C. § 501(c)(3) credit counseling industry, all of which resulted in termination or proposed termination of tax-exempt status); Permanent Subcomm. on Investigations, Profiteering in a Non-Profit Industry: Abusive Practices in Credit Counseling, S. REP. 109-55, at 32 (2005) (imposing regulations on credit counseling organizations); Press Release, Internal Revenue Service, IRS Takes New Steps on Credit Counseling Groups Following Widespread Abuse (May 15, 2006), available at http://www.irs.gov/newsroom/article/0,,id=156996,00.html (discussing the IRS’s approach to credit counseling organizations); Colinvaux, supra note 84, at 47–49 (discussing the profit models and tax evasion of credit counseling organizations).
\end{itemize}
on what activities qualify as “scientific.” Those limitations require that such activities involve “basic” research and have other characteristics demonstrating public benefit, such as government funding or public dissemination. The Treasury Department designed these limitations to prevent organizations engaged in research activities that primarily provided private, as opposed to public, benefit from qualifying as charities.

In these situations, Congress and Treasury generally chose not to dictate what specific public-benefitting activities the charities at issue should engage in. Instead, they chose to prohibit certain problematic activities and/or indirectly influence the choice of public-benefitting activities by requiring certain governance changes. For example, neither Congress nor the IRS has dictated the mix of medical services that a charity hospital must offer or even—at least so far—how much free care such an entity must provide. Private foundations are free to pursue almost any activity (other than lobbying) permitted to charities generally, although they must comply with more onerous procedural requirements in many instances. The one significant, recent exception is credit counseling agencies—and there, Congress was responding to pervasive and egregious violations in a very specific area. Whether consciously or not, Congress and Treasury therefore have acted as if they recognize that dictating exactly what charities have to do would be problematic in most instances. As detailed previously, this approach is the correct one because such protection of charities from government influence is necessary if charities are to fulfill their societal role of being distinct from, among other groups, governments, unless specific, government-mandated restrictions are needed to offset the negative, private-benefitting influence of individuals or other groups.

2. Lenders

Lenders are another set of private parties that presumably would use their market influence—in this case, the market for debt financing—over a charity to redirect its activities to their benefit if

147. See Rev. Rul. 76-296, 1976-2 C.B. 142 (explaining the public dissemination aspect of the regulations in these terms).
148. See supra note 89 and accompanying text.
150. See supra note 145 and accompanying text; see also I.R.C. § 501(q).
they could do so.\textsuperscript{151} It is the ability to do so, however, that does not appear to exist. If a lender is truly a lender, as opposed to a disguised equity investor, then the only obligation that the charity has to the lender is to repay the amount borrowed plus interest, not, as is the case with an equity investor, to maximize profits overall. The influence of lenders is also limited by the fact that charities cannot be forced into bankruptcy and by the other restrictions on lenders even when a charity voluntarily chooses to file for bankruptcy.\textsuperscript{152} At the same time, charities that voluntarily choose to file for bankruptcy enjoy the same protections from creditors provided to other entities, including the automatic stay on creditors' claims.\textsuperscript{153} A charity could, of course, agree to give a lender more authority over the charity than a plain vanilla loan would provide, but such an agreement would have to comply with both the nondistribution constraint and the fiduciary duties of the charity's board members. There also does not appear to be any evidence that lenders have often sought or obtained such authority, much less authority that would threaten the charity's ability to provide public benefit.

3. Sellers of Goods and Services

Similarly, sellers of goods or services to a charity might also be able to use their influence to push the charity away from providing public benefit and pull it toward providing them with a private benefit. Setting aside charity managers, addressed above, and given the private inurement and private benefit restrictions, a charity's only obligation to a seller of goods and services is to pay the price of such goods and services, however, not to alter in any way the charity's overall mission. With one exception, there again does not appear to be any significant evidence of improper seller influence over a charity other than situations where the seller has ties to a charity insider—

\textsuperscript{151} See Robert J. Yetman, Borrowing and Debt, in FINANCING NONPROFITS, supra note 99, at 243, 244 (stating that sixty percent of nonprofits have some form of debt outstanding, with an average debt to assets ratio of thirty-three percent, based on IRS statistics).

\textsuperscript{152} See 11 U.S.C. § 303(a) (2006) (prohibiting involuntary bankruptcy cases against "a corporation that is not a moneyed, business, or commercial corporation"); id. § 363(d)(1) (prohibiting a bankruptcy trustee from violating nonbankruptcy law that governs the transfer of property owned by such a corporation); id. § 1112(c) (prohibiting bankruptcy courts from forcing such corporations to convert from a chapter 11 reorganization to a chapter 7 liquidation); S. REP. NO. 95-989, at 32 (1978) (explaining that such corporations are "[c]eleemosynary institutions, such as churches, schools, and charitable organizations and foundations").

\textsuperscript{153} 11 U.S.C. § 362(a), (b).
that is, someone covered by the private inurement prohibition and therefore potentially exposed to the intermediate sanctions.\textsuperscript{154}

The one exception is in the fundraising area. There is evidence that for-profit fundraisers have become so important to certain charities that the fundraiser has arguably been able to alter the charity's fundraising operations so as to primarily benefit the fundraiser. The case of United Cancer Council ("UCC") is an example of this situation.\textsuperscript{155} In that case, the Seventh Circuit Court of Appeals found that the fundraiser received more than ninety percent of the donations raised and also co-owned the donor list generated by the various fundraising appeals.\textsuperscript{156} Furthermore, this case does not appear to be an isolated incident in that there are a number of recent state attorney general reports stating that many other charities pay similar percentages of contributions to commercial fundraisers.\textsuperscript{157}

The UCC case and other examples of for-profit fundraisers receiving the vast majority of contributions are troubling, particularly because many of these situations, including that of UCC, apparently involved otherwise independent charities that voluntarily chose to enter into such a relationship with a for-profit fundraiser.\textsuperscript{158} It does not appear, however, that this behavior generally extends beyond the fundraising context for two reasons. First, the incentive for charity leaders to enter into such relationships is relatively clear but limited to fundraising: any money the charity receives as a result of the campaign run by the fundraiser is arguably money the charity otherwise would not have received and so tends to be viewed as "found money." The fact that in the course of the charity obtaining these new

\textsuperscript{154} See supra notes 137, 140 and accompanying text.

\textsuperscript{155} United Cancer Council, Inc. v. Comm'r, 165 F.3d 1173, 1174-75 (7th Cir. 1999).

\textsuperscript{156} Id. at 1175-79.

\textsuperscript{157} See, e.g., CHARITIES BUREAU, N.Y. STATE DEPT. OF LAW, PENNIES FOR CHARITY: WHERE YOUR MONEY GOES i (2009), available at http://www.charitiesnys.com/pdfs/2009_Pennies.pdf (reporting that for 584 telemarketing campaigns for charities in 2008, in over eighty percent of them the charities kept less than half of the funds raised and in nearly half of them, the charities received less than thirty percent); OFFICE OF THE ATTORNEY GENERAL, CALIFORNIA DEPT OF JUSTICE, SUMMARY OF RESULTS OF CHARITABLE SOLICITATIONS BY COMMERCIAL FUNDRAISERS IN CALENDAR YEAR 2009, at 1 (2010), available at http://ag.ca.gov/charities/publications/2009cfr/cfr2009.pdf (reporting that the average distribution to charities by commercial fundraisers was less than forty-three percent of the funds raised); Lloyd H. Mayer, 'Tis the Season . . . For Charitable Solicitation Reports?, NONPROFIT L. PROF BLOG (Dec. 15, 2009), http://lawprofessors.typepad.com/nonprofit/2009/12/tis-the-season-for-charitable-solicitation-reports.html (summarizing reports from Massachusetts, Vermont, and Washington showing an average payment to charities of forty-two percent or less of funds raised).

\textsuperscript{158} See United Cancer Council, 165 F.3d at 1173 ("The IRS claims that UCC . . . was operated for . . . the private benefit of the fundraising company that UCC had hired . . . .") (emphasis added).
funds the fundraiser received as much (or even ten times as much) as the charity may therefore be perceived by the charity’s leaders as irrelevant because those funds never “belonged” to the charity in their eyes. In contrast, almost any other provider of goods or services will not be able to provide “money for nothing.” 159 Second, there is no evidence of such systematic, private-benefit-resulting influence by vendors in other contexts.

This situation suggests that the government should do more to address the relationships of charities with fundraisers. Here, however, the government’s hands are tied by a string of Supreme Court constitutional decisions that prohibit federal, state, or local governments from putting limits on the percentage paid to commercial fundraisers or even requiring such fundraisers to tell potential donors up front how much of the proceeds are actually going to the named charity. 160 It is for this reason that state attorneys general and the Federal Communications Commission have been forced to resort to public education, mandatory registration and reporting, and fraud prosecutions. 161 The effectiveness of these measures is unclear, particularly given the apparent continued receipt by fundraising firms of the lion’s share of contributions for a significant number of charities. 162 While the Uniform Commercial Code case left open the possibility of revoking the tax-exempt status of the charity involved under the private benefit doctrine, more targeted tax rules or state laws are probably constitutionally problematic given the line of Supreme Court cases mentioned above. 163 Absent a change in the constitutional case law, further government regulatory remedies for this situation are therefore probably unavailable.

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159. The one exception might be investment managers, but even they generally must pay themselves out of their returns on the charity’s funds, not out of what should be (but in the fundraising context may not be) seen as the charity’s money in the first place.

160. See Madigan v. Telemarketing Assocs., 538 U.S. 600, 612–17 (2003) (summarizing this line of cases but concluding they did not prohibit states from pursuing fraud actions based on false or misleading charitable solicitations).


162. See supra note 157.

163. See United Cancer Council, 165 F.3d at 1179–80 (noting that on remand, the United Cancer Council’s tax-exempt status might be revoked under the private benefit doctrine and declining to prejudge those proceedings).
4. Purchasers of Goods and Services

Charities also sell goods and services in the marketplace and, in some instances, are almost wholly dependent on the fees paid by purchasers of these goods and services. With respect to activities that are considered inherently charitable, such as providing education and health care (the latter subject to certain conditions), charities are permitted to charge full market value with few if any conditions, in which case the potential influence of purchasers over the charity must be considered. Outside of these activities, however, the influence of purchasers is much more limited because these sales are generally considered charitable only if provided to an identified charitable class (which can consist of other charities) at charges that are no more than “substantially below cost,” a term that the IRS has indicated means at least eighty-five percent below cost. As discussed previously, the distinction between services—and it is almost always services—that are inherently charitable and services that are not appears to be based on a determination by either Congress or the Treasury Department that certain services provide a more than incidental public benefit even when purchased by consumers at fair-market-value prices. Besides education and health care, other, more limited examples are providing some types of services to certain groups, specifically children and the elderly. In both instances the charging of fair-market-value

165. With respect to children, Congress has declared that providing child care will be considered educational within the meaning of section 501(c)(3) as long as the services are available to the general public and the care is provided for purposes of enabling individuals to be gainfully employed. See I.R.C. § 501(k) (2006); see also David M. Blau & H. Naci Mocan, The Supply of Quality in Child Care Centers, 84 REV. ECON. & STAT. 483, 483 (2002) (“Arguments for government intervention in the child care market are often based on the externalities generated by exposing children to high-quality care.”); Anne E. Preston, Efficiency, Quality, and Social Externalities in the Provision of Day Care: Comparisons of Nonprofit and For-Profit Firms, 4 J. PRODUCTIVITY ANALYSIS 165, 165 (1993) (“[D]ay-care services generate social externalities such as care and education of children and labor productivity of young women.”). With respect to the elderly, the IRS has ruled that providing retirement community services to the elderly will be considered charitable as long as such services meet three primary needs: housing, health care, and financial security. Rev. Rul. 72-124, 1972-1 C.B. 145; see also Elizabeth C. Kastenberg & Joseph Chasin, Elderly Housing, EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION TECHNICAL INSTRUCTION PROGRAM FY 2004 (2003), available at http://www.irs.gov/pub/irs-tege/eotopic04.pdf; David A. Brennan, The Commerciality Doctrine as Applied to the Charitable Tax Exemption for Homes for the Aged: State and Local Perspectives, 76 FORDHAM L. REV. 833, 847 (2007) (arguing that the restrictions imposed by the IRS ruling represent an application of the commerciality doctrine—i.e., whether the manner of providing such services is sufficiently distinguishable from the provision of such services by for-profit entities—as opposed to an implementation of the public benefit requirement). But see Rev. Rul.
fees is permitted. Perhaps not surprisingly, in these five areas—health care, education, retirement communities, day care, and physical fitness—there are also significant numbers of for-profit and government providers, although the percentage of providers of each type varies significantly between these areas.  

For services and goods that do not fall into any of these categories, a charity may still charge consumers more than substantially-below-cost fees, but the activity will usually be considered an unrelated trade or business, and its net income will be subject to federal (corporate) income tax. Classification as an unrelated trade or business often also causes the loss of other benefits normally enjoyed by charities, including access to tax-exempt bond financing for facilities used in that trade or business and real property tax exemption for such facilities. If an unrelated trade or business activity becomes too large a part of the organization's overall activities, then the organization's status as a charity will also be at risk. Likely for these reasons, as well as the complexity of administering an unrelated trade or business and the possible negative public perception such activity may generate, the vast

166. See Hansmann, supra note 28, at 246 (providing statistics on distribution of ownership forms in services including health care, old-age care, child care, and education). Other possible areas are the arts, zoos, and aquariums, although in those areas the diversity of activities makes it less clear that charity and for-profit entities actually engage in similar activities. Moreover, such organizations are often less reliant on fees for service than charities operating in the other four areas. See Louis Cain & Dennis Meritt, Jr., Zoos and Aquariums, in To PROFIT OR NOT TO PROFIT, supra note 76, at 217, 222; (providing statistics on financing mechanisms available to zoos and aquariums); Helmut K. Anheier & Stefan Toepler, Commerce and the Muse: Are Art Museums Becoming Commercial?, in To PROFIT OR NOT TO PROFIT, supra note 76, at 233, 241. (providing statistics on revenue sources for various types of museums).


168. See INTERNAL REVENUE SERVICE, TAX-EXEMPT BONDS FOR 501(c)(3) CHARITABLE ORGANIZATIONS COMPLIANCE GUIDE 3 (2005) (classifying unrelated trade or business use of tax-exempt bond-financed property as private-business use, of which only a limited amount is allowed); see also Gallagher, supra note 33, at 7–8 (discussing divergence in tax treatment of real estate holdings by charities used for both exempt and nonexempt purposes among states).

majority of charities do not engage in such activities at all. Those charities that do engage in unrelated trade or business activities usually ensure that they are relatively minimal, even considering the possibility that there is significant underreporting of such activities.\textsuperscript{170}

Purchasers of these goods and services are therefore unlikely to have much influence on charities except in rare instances.

This is not to say that the unrelated trade or business-income tax structure is perfect or captures all of the income that it should, nor does it say that charging fees at a rate substantially below cost is the only way to avoid unrelated trade or business treatment. For example, the courts have repeatedly ruled and the IRS has accepted that religious publishing can be substantially related to the accomplishment of charitable or religious purposes even if the resulting publications are sold at or above cost if certain other indicia of noncommerciality are present.\textsuperscript{171} These indicia include selecting works to publish based on criteria other than potential profitability and distributing them in a manner designed to further that purpose, which can but is not required to include charging at or below cost.\textsuperscript{172}

That said, however, there are clearly activities that do not require such “noncommercial” indicia to be treated as furthering charitable or educational purposes. In these situations, where charities are permitted to charge full market value with few if any conditions, the influence of the purchasers must be considered. As already noted, such items tend to be services and, most prominently but not exclusively, education and health care. Setting aside the issue of a single large purchaser—who, if it had substantial influence over a charity, would be subject to the private inurement prohibition and the


\textsuperscript{171} See, e.g., Presbyterian & Reformed Publ’g Co. v. Comm’r, 743 F.2d 148, 158–59 (3d Cir. 1984) (reversing revocation of tax-exempt status for appellant because increased business due to increased popularity of publisher’s author did not show substantial nonexempt purpose); Pulpit Resource v. Comm’r, 70 T.C. 594, 612–13 (1978) (holding that petitioner qualifies as an exempt organization, the robust nature of its publishing business notwithstanding, because it was organized and operated exclusively for charitable purposes). See generally Internal Revenue Service, IRC 501(c)(3) Organizations and Publishing Activities, Exempt Organizations Continuing Professional Education Technical Instruction Program FY 1988 (1987), available at http://www.irs.gov/pub/irs-tege/eotopice88.pdf (discussing the circumstances under which religious publishing may be considered substantially related to the accomplishment of charitable or religious purposes).

\textsuperscript{172} Internal Revenue Service, supra note 171, at 9–12.
intermediate sanctions rules discussed previously—the issue raised by
these consumers is whether they pose any risk to the public benefit
commitment of charities that rely heavily on their payments. Given
the growth of reliance by charities on such consumers, documented in
the next Part, this is an important concern. This concern is also
difficult to dismiss both because it is generally accepted that in most
markets consumer demands affect the behavior of producers—a
manifestation of the famous “invisible hand”—and because it is not
clear that consumers from charities, such as hospital patients and
school students (and their parents), desire the charities with which
they interact to produce public benefits as opposed to private benefits
for those consumers. The extent of this influence is uncertain,
however, for a variety of reasons detailed in the next Part.

III. THE RISKS TO AUTONOMY FROM FEE-FOR-SERVICE CHARITY

This Part explores the potential influence of consumers on
charities, first by noting the growing reliance of charities on fees for
services generally and especially in certain areas, and second by
considering if and under what conditions such reliance could lead to
consumer desires pulling a charity away from providing public benefit.

A. The Growing Reliance by Charities on Fees from Consumers

One of the most dramatic historical trends for charities is the
growing reliance on fees for service as a source of revenue. While the
conventional wisdom is that charities rely primarily on private
donations, this has not been the case for many decades. In fact, no
major category of charities other than international organizations,
private foundations, and probably religious congregations now relies
for a majority of its financial support on private contributors. As of
2005, payments for services constituted almost seventy percent of
total revenues for charities, while private donations and government
grants were only a little over twenty percent.¹⁷³ While these figures do
not include the value of services donated to charities, which is
significant, existing data indicates that the incidence of volunteer
service has a rough correlation with the incidence of financial
contributions.¹⁷⁴

¹⁷⁴. See CORP. FOR NAT’L & CMTY. SERV., VOLUNTEERING IN AMERICA 2010: NATIONAL,
gov/assets/resources/IssueBriefFINALJune15.pdf (noting a significant rise in volunteering
activity nationwide in 2009); WING, supra note 173, at 34, 89, 97; Lester M. Salamon & S.
These figures mask significant variations between different types of charities and even within the same type. For example, health care charities, within which area hospitals control the vast majority of revenues and assets, rely very little on private donations (less than 2.4 percent of total revenues in 2005). In contrast, the reliance of educational and human service charities is relatively close to the sector-wide average, while arts and culture charities, environmental charities, religious organizations, and charities that exist primarily to support other charities have a much higher reliance on private contributions. While not an exact correlation, a low reliance on private donations and government grants generally accompanies a high reliance on fees for services from private and government sources, as revenue from other sources is usually modest.

This reliance on fees for service is a historical shift, although the timing and degree of that shift varies between different types of charities. For example, the now eighty-five-percent reliance of charity hospitals on fees is primarily a phenomena from the second half of the twentieth century while the reliance of educational

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175. See Cong. Budget Office, Taxing the Untaxed Sector 7 (2005) (for tax-exempt nonprofits in 2001, showing program revenue percentages ranging from ten percent to over ninety percent depending on the primary area of activity).


178. See Wing, supra note 173, at 146 (demonstrating that for all charities other than private foundations, these other sources, including investment income, accounted for less than ten percent of total revenues).


180. See Overview of the Tax-Exempt Sector: Hearing Before the H. Comm. on Ways & Means, 109th Cong. 39, 49 (2005) (statement of George K. Yin, Chief of Staff, Joint Committee on Taxation) ("Historically, charitable hospitals were characterized as voluntary because they generally were supported by philanthropy, staffed by doctors who worked without compensation,
institutions on fees has been more gradual and, at least comparatively, weaker.\textsuperscript{181} For universities, private payers are not limited to students and their parents, as consumers in the education context include the attendees and viewers of sporting and other school events, licensees of school-owned intellectual property, and others.\textsuperscript{182}

This increased reliance on fees for service leads to a plethora of concerns. Such concerns include an undue focus by charity leaders on economic efficiency and the bottom line, to the detriment of the charity’s mission; selection of leaders primarily for their ability to produce profits as opposed to advancing the organization’s charitable purposes; and a lack of responsiveness to public and beneficiary concerns. The feared effect of these numerous issues is that identified at the end of the previous Part—reliance on such fees will detract from providing public benefit. This abandonment of public benefit is usually in some form of perceived degradation of the public-benefitting activity, whether a lowering of the quality of the services provided without reducing the fees charged or other changes to how that service

\textsuperscript{181} See \textsc{Frederick Rudolph}, \textit{The American College and University: A History} 177–200 (1990) (explaining that through most of the nineteenth century educational institutions depended primarily on private contributions of money and time—particularly from low-paid faculty—and also a significant amount of government support, while fees paid by students and their families were modest); Arnsberger & Graham, \textit{supra} note 170, at 174 (noting that education charities reported $149 billion in program service revenue and $92 billion in contributions, gifts, and grants for tax year 2007 as compared to $293 billion in total revenue); \textit{Earl F. Cheit & Theodore E. Lobman, III, Private Philanthropy and Higher Education: History, Current Impact, and Public Policy Considerations, in II RESEARCH PAPERS, supra note 39, at 453, 458, 464 (1977) (showing a decreasing reliance on private contributions and increasing reliance on public funds—including student-directed funding streams—over time); Elchanan Cohn & Larry L. Leslie, \textit{The Development and Finance of Higher Education in Perspective, in SUBSIDIES TO HIGHER EDUCATION: THE ISSUES 11, 18 (Howard P. Tuckman & Edward Whalen eds., 1980) (indicating that fees from students were once modest).}

\textsuperscript{182} See, e.g., Walter W. Powell & Jason Owen-Smith, \textit{Universities as Creators and Retailers of Intellectual Property: Life-Sciences Research and Commercial Development, in TO PROFIT OR NOT TO PROFIT, supra note 76, at 169, 181–93 (describing other private payers for educational or technological services provided by colleges and universities beyond students and their parents, namely, consumers of intellectual property created in university settings). See generally \textsc{Derek Bok, Universities in the Marketplace: The Commercialization of Higher Education} (2003) (discussing broad trends towards commercialization of university financial goals and management); \textit{Risa L. Lieberwitz, The Marketing of Higher Education: The Price of the University’s Soul, 89 CORNELL L. REV. 763, 798–99 (2004) (reviewing Bok, \textit{supra}, and concluding that Bok is not sufficiently critical of commercialization’s negative effect on the public mission of colleges and universities).}
is provided or fees are collected, such as the mix of medical services provided, the extent of community outreach, and the aggressiveness of bill collectors.\textsuperscript{183}

What tends not to be clearly identified is that this common concern arises from the simple fact that as charities rely more and more on the purchasers of their services (i.e., on consumers), the collective desires of those consumers potentially gain greater influence over charities. Even aggressive bill collection or reduced charity care could be seen as indirectly reflecting consumer preferences because most if not all consumers who perceive themselves as paying “full freight” presumably are not interested in providing cross-subsidies to other customers who either fail to pay their bills or lack the means to do so. It is therefore not usual that charity leaders are acting in bad faith, such as by seeking to enrich themselves—a concern that is already addressed directly by the private inurement prohibition and intermediate sanctions; they are simply responding to the market reality faced by the organizations they manage. Furthermore, little systematic attention has been paid to whether and when in fact this potential negative outcome actually comes to pass. The remainder of this Part considers if and when reliance on fees for service is likely to pull a charity away from providing public benefit. As will be seen, there are a number of factors that likely affect whether consumer desires have this effect.

B. The Effects on Charities of Consumer Reliance

To understand both the possible influence of consumers on charities and the limits on that influence, it is helpful to start with the world as imagined by classical economics. In that mythical world, where all actors have perfect information and act rationally to maximize utility (individuals) or profits (organizations) and there are no transaction costs, the desires of consumers would have an immediate and direct effect on the activities of charities that rely on the fees paid by those consumers. The only hindrance to those desires pulling a charity away from providing public benefit, absent legal restrictions, would then be if the consumers’ desires happened to coincide with providing public benefit. For example, if all that consumers desired from a child care center was adequate and efficiently provided child care, that desire would not detract a charity that relied on those consumers from providing public-benefitting child care.

\textsuperscript{183} See supra notes 1–6 and accompanying text.
care. If, however, those consumers also desired services that do not provide public benefit, such as students (and parents) at charity schools desiring five-star-restaurant quality food, five-star-hotel quality dorm rooms, and a national championship football team, responsiveness to those desires would lead charity schools to direct some of their limited resources to providing such private benefits instead of providing public benefits. Determining whether there was a need for the law to counter consumer influence in order to ensure that charities provide public benefits would then depend only on the extent to which the desires of a particular charity’s consumers departed from goals that provide public benefit.

In the real world, however, such legal intervention may not be needed even when consumers primarily desire private, not public, benefit because there are a number of factors that could counter or disrupt the influence of consumer desires over even a charity that is completely reliant on the payments from such consumers. Relaxing the assumption that consumers have perfect information, these consumers may be unable to accurately judge whether they are in fact receiving what they desire. For example, there is evidence in the child care area that most parents are not very good at assessing the quality of child care provided even though experts generally agree on how to measure such quality. Therefore, even if child-care-center consumers desire higher quality child care than would be socially optimal for a center to provide—perhaps because providing care of the desired quality would require charging fees that would be unaffordable to many who need child care services—the center might very well be unmoved by that desire since the consumers are unable to

184. See Gordon Cleveland & Michael Krashinsky, The Nonprofit Advantage: Producing Quality in Thick and Thin Child Care Markets, 28 J. POL’Y ANALYSIS & MGMT. 440, 441–42 (2009) (assuming parents desire high quality child care, but noting that child care markets depart from the classical economics model in a number of important respects, including with respect to the consumer’s ability to judge quality and the fact that child care services often operate in thin markets with little competition).

185. See Richard Arum & Josipa Riksa, Op-Ed., Your So-Called Education, N.Y. TIMES, May 15, 2011, at W10 (“[S]tudents are increasingly thought of, by themselves and their colleges, as ‘clients’ or ‘consumers.’ When 18-year-olds are emboldened to see themselves in this manner, many look for ways to attain an educational credential effortlessly and comfortably. And they are catered to accordingly. The customer is always right.”).

186. See, e.g., Debby Cryer & Margaret Burchinal, Parents as Child Care Consumers, in COST, QUALITY, AND CHILD OUTCOMES IN CHILD CARE CENTERS: TECHNICAL REPORT 203, 209 (Suzanne W. Helburn & Mary L. Culkin eds., 1995) (concluding that parents were impeded in acting as well-informed consumers of child care by the difficulties of monitoring the care their children actually received); Naci Mocan, Can Consumers Detect Lemons? An Empirical Analysis of Information Asymmetry in the Market for Child Care, 20 J. POPULATION ECON. 743 (2007) (arguing that a comparison of parental evaluation of quality to actual quality demonstrates that parents are weakly rational in their judgments of quality in the U.S. child care market).
judge whether they are in fact receiving what they want. The center could then provide the quality of care that the center’s leaders determine best serves the community.

Similarly, a charity lacking perfect information about those who purchase services from the charity may assume that those purchasers’ desires are consistent in all respects with the charity providing public benefit even if they are not. For example, even if students (and their parents) want luxurious dorm rooms, a school may assume that their only desire is for quality education and so the school will not shift resources away from education to residence halls. Consumers may also not be rational utility maximizers, particularly if utility is equated with financial well-being, but they may instead react to all sorts of other desires, such as the desire to be associated with an organization that has a strong reputation with respect to helping the community (or, less positively, with winning basketball games).

Charities are not, of course, generally viewed as profit-maximizing entities for the simple reason that no individual is able to ultimately receive those profits. There are still certain advantages to profitmaking for charity leaders, however, including the ability to satisfy the commonly assumed desire to empire build.\textsuperscript{187} The extent to which charity leaders seek to maximize profits even if they are unable to directly receive those profits is therefore another relevant factor. But empire building and similar activities may be constrained by both inside and outside observers, whether beneficiaries, staff, the media, government officials, or others.

Relaxing the assumption of no transaction costs with respect to entry and exit into a particular field of activity could also result in a number of barriers to consumer desires changing charity behavior. For example, if a charity hospital is the only hospital within reasonable distance for the residents of a particular geographic area and the cost of establishing another hospital in that area is prohibitively high, the charity hospital may be able to use its monopoly position to ignore consumer desires. There is reason to believe that many child care centers are in a similar position because of the limited geographic reach of such centers, although the lack of “thick” markets for most charity child care centers may actually reduce the ability of those

centers to provide public benefit through higher quality, more efficiently provided child care.\textsuperscript{188}

Finally, other influences may counter the influence of consumers even for a charity that relies solely on fees paid for its services. For example, strong internal leadership may resist "catering" to consumers to the detriment of providing public benefit. Such resistance is potentially stronger if the leadership has access to other sources of funds, such as private contributions or investment income, and is not dependent on consumers. This ability to resist outside influences is in fact one of the arguments made in support of creating and maintaining significant endowments.\textsuperscript{189} Accountability to a third party that is not directly subject to consumer influence may also serve as a counter.\textsuperscript{190} Such a third party might be an accreditation or other standard-setting entity, or a charitable affiliate that does not rely on income from the primary charity. For example, research with respect to hospitals has produced at best mixed results with respect to whether charity hospitals provide—as the contract-failure theory predicts—higher quality care than for-profit hospitals.\textsuperscript{191} This result may be attributable to the common accreditation standards that apply equally to both types of hospitals as well as to the medical professionals who staff them.\textsuperscript{192} In contrast, that research indicates that for-profit and charity hospitals do often differ with respect to the mix of services that they provide—with charity hospitals more likely to provide services with lower or even negative profit margins—an area that generally is not covered by hospital accreditation or physician-licensing standards.\textsuperscript{193} Similarly, research with respect to child care indicates that charity child care centers are relatively

\textsuperscript{188} See Cleveland & Krashinsky, supra note 184, at 458 ("[W]hen markets are thin, demand for high quality child care is insufficient to support quality differentiation across producers, and nonprofits . . . are generally not able to produce child care services of significantly higher quality than in for-profits.").

\textsuperscript{189} See Henry Hansmann, Why Do Universities Have Endowments?, 19 J. LEGAL STUD. 3, 29–32 (1990) (describing the history of the creation of university endowments, including original need to self-support given divergence in some universities' religious affiliations with those of their state legislatures, noting ongoing importance of this rationale to continued use of endowments).

\textsuperscript{190} See, e.g., Kathleen M. Boozang, Does an Independent Board Improve Nonprofit Corporate Governance?, 75 TENN. L. REV. 83, 117 (2007) (noting the influence of such entities on nonprofit organizations).

\textsuperscript{191} See Schlesinger & Gray, supra note 75, at 383 (noting that empirical evidence does not demonstrate clearly whether charity hospitals provide higher quality care than their for-profit counterparts).

\textsuperscript{192} See id. at 393.

responsive to state regulatory demands (and more responsive than their for-profit counterparts). Significant variations in the strength of other influences probably also exist within charities operating in the same field. For example, religiously affiliated charities may be subject to countervailing influences that their nonreligious counterparts do not face.

This discussion indicates that consumers collectively pulling charities away from providing public benefit may be a real risk for charities that rely heavily on payments from those consumers, but that there are a number of factors that tend to counter this risk. Only in the absence of such factors will it therefore be necessary to reach the difficult-to-answer question of whether legal intervention is required. How to address the dangers of consumer influence will therefore vary depending on the particular circumstances faced by a particular group of charities or even a specific charity. The next Part explores possible options for addressing this risk, including what considerations should generally guide choosing among these options.

IV. OPTIONS FOR ADDRESSING THE RISKS OF FEE-FOR-SERVICE CHARITY

There are several ways to address the potential consumer-influence breach in the legal wall protecting charity autonomy identified above. One option would be to try to eliminate the influence of consumers entirely. Another option would be to strengthen other influences so that they can counter consumer influence—that is, creating a balance of power that will sufficiently restrain consumer influence in most if not all cases. A third option, which is a refinement of the second option, would be to require charities that rely

194. See, e.g., Elizabeth Rigby et al., Child Care Quality in Different State Policy Contexts, 26 J. POLY ANALYSIS & MGMT. 887, 903 (2007) (noting the “marked difference . . . in the responsiveness to policy of nonprofit and for-profit child care centers” at the state level, with the former being relatively more responsive).

195. See DiMaggio & Anheier, supra note 27, at 149 (“Studies that distinguish between religious and secular [nonprofit organizations] often find systematic differences between them.”); Schlesinger & Gray, supra note 75, at 397 & n.34 (discussing the difficulty of taking religious affiliation, which is highly correlated with nonprofit ownership, into account empirically but noting that it has generally been found to be associated with greater accessibility for independent patients and lower costs for hospital services).

196. See Cleveland & Krashinsky, supra note 184, at 458 (“Failure to account for heterogeneity in market conditions faced by different nonprofit organizations is likely to deliver a verdict that nonprofit organizations have no advantage in producing quality.”); DiMaggio & Anheier, supra note 27, at 150 (asserting that a variety of factors influence the type and extent of differences in the behavior of nonprofits and other types of entities (public and for-profit) in the same industry).
significantly on fees for services to disclose additional information about their activities to enhance the ability of both government entities and the public to detect and counter the adverse effects of consumer influence.

A. Eliminating Consumer Influence

Setting aside the practical and political difficulties inherent in this choice, one option would be to bar organizations seeking to qualify as charities from receiving payment of fair market fees for any services (or goods), thereby eliminating consumer influence over charities. This approach is the one taken with respect to capital investors for all nonprofits, including charities, and therefore is not without precedent. It also has the advantage of establishing a clear and easily enforceable bright-line rule.

Congress and the Treasury Department have in fact already chosen this option to a limited extent. With respect to the provision of services or goods that are neither deemed inherently public benefitting nor provided in such a way as to distinguish their provision from that of for-profit entities, charities are already prohibited from primarily engaging in these activities and are required, generally, to pay federal (and usually state) income tax on these sales. For example, the provision of management consulting services in exchange for fair-market-value payment, even if the delivery of services is limited to other nonprofit organizations, does not further a permitted purpose for a charity. The sale of most types of services and goods for fair market value absent some distinguishing feature, such as charging substantially below cost or obtaining the goods to be sold through donations, is therefore already barred to charities as their primary activity and usually results in partial withdrawal of legal benefits. Congress and the Treasury Department continue to look for other activities that should be treated in this manner, as demonstrated by the recent rules prohibiting credit counseling organizations from qualifying as charities if, among other new conditions, they engage in certain activities. These activities include providing services for the purpose of improving a consumer's credit record, credit history, or credit rating (unless such services are

197. See supra notes 137–138 and accompanying text.
198. See supra notes 167, 169 and text accompanying notes 166, 167.
only incidental to providing credit counseling), or receiving any amounts for providing referrals to others for debt-management plan services.\textsuperscript{201}

Both the credit-counseling example and the previous discussion indicate, however, why this option should not be applied on a blanket basis. Absent a situation where consumer desires both depart from providing public benefit and have the actual effect of significantly moving a charity away from providing public benefit, such a draconian solution is not needed. For the reasons already discussed, neither condition applies universally. Consumer desires may, for the most part, align with providing public benefit, such as when consumers primarily or solely desire an adequate and efficiently provided service where that service inherently provides public benefit. Probably more commonly, numerous other circumstances may ameliorate or even eliminate the influence of consumer desires, such as market characteristics or the influence of third parties.

The downside of choosing this option when it is not needed is that organizations that otherwise deserve the legal benefits provided to charities would lose a significant source of financial support as well as the “halo” effect that comes with being a charity. As a result, such organizations would necessarily be fewer and less able to provide public benefits for no good reason. For example, say a nonprofit organization is the sole hospital within reasonable driving distance for the residents in a particular geographic area. The people in the area are moderately well off, such that the hospital can only provide minimal charity care—lacking poor patients—but also must keep its fees relatively low to be affordable to the residents and so essentially breaks even from year to year once the legal benefits it enjoys as a charity are taken into account. The hospital is relatively immune to consumer influences because it has a monopoly on hospital medical care in the area. No for-profit hospital will enter this market, even assuming low transaction costs to do so (such as if it would be relatively inexpensive to purchase the nonprofit’s facilities) because the profit margins from serving this community are too low.\textsuperscript{202} If, however, the legal benefits are removed because the organization


\textsuperscript{202} See Marco A. Castaneda & Dino Falaschetti, Does a Hospital’s Profit Status Affect Its Operational Scope?, 33 REV. INDUS. ORG. 129, 145 (2008) (concluding that the location decisions of not-for-profit hospitals “will fundamentally differ from the location decisions of for-profit hospitals”). But see Jeffrey P. Ballou, Do Nonprofit and Government Nursing Homes Enter Unprofitable Markets?, 46 ECON. INQUIRY 241, 257 (2008) (concluding that charity and for-profit nursing homes typically enter similar markets, in contrast to government nursing homes, which are more likely to enter unprofitable markets).
relies exclusively on fees for service, it may be forced to close its doors, thereby depriving this community of hospital medical care. This potential for throwing the baby out with the bathwater suggests that in many if not most instances of possible negative consumer influence, a more nuanced approach is more appropriate. Absent elimination of that influence, the logical alternative would be to reduce the impact of that influence by introducing or strengthening other influences that push charities toward providing public benefit.

B. Counterbalancing Consumer Influence

As previously detailed, there are a number of other potential sources of influence over charities. The influence of some of those sources is limited under existing law because of their likelihood to direct a charity away from providing public benefit. Other sources have the potential to enhance or catalyze the ability of a charity to stay true to providing public benefit even if that charity relies heavily on fees for service.

One obvious catalyst is the government itself. The danger with reliance on this source, however, is that, to the extent the government curtails the specific activities in which a charity can engage, it also curtails the ability of a charity to pursue a public-benefitting purpose in a manner that departs from the ways that can garner sufficient political support at that time. That is, while using government influence to counter consumer influence is unlikely to lead to private benefit, it does undermine one of the ways that charities operate in a manner distinct from that of government. Also, the more that government micromanages a charity's activities, the more a charity comes to lose the nonbureaucratic character that is another distinguishing feature from government.

There are, however, other possible sources of public-benefit-seeking influence. As John Colombo and Mark Hall have developed in detail, donors as a group may help provide that influence if they represent a sufficient source of financial (or possibly volunteer service)

203. See generally John D. Colombo, Why We Need an Alternative to Community Benefit: Evidence from the IRS Hospital Compliance Project Final Report, 63 EXEMPT ORG. TAX REV. 479, 479–80 (2009) (noting that a recent IRS report concluded critical access hospitals (“CAHs”), which provide access to health services otherwise unavailable to their surrounding community, devoted only 2.8 percent of their revenues on average to “community benefit” because the IRS’s calculation failed to take into account the community benefit indicated by CAH status).
support for a charity.\textsuperscript{204} While Colombo and Hall saw such donor involvement as primarily signaling that a given organization in fact provides a good or service that is subject to government and market failures, a certain required level of donor involvement and financial dependence by the charity could also counterbalance consumer influence that otherwise would push the charity away from providing public benefit.

Other possible sources can easily be imagined. There is evidence that the existence of a third party uninfluenced by consumers can hold a charity to account if that third party is itself dedicated to ensuring that the charity provides public benefit. For example, accreditation agencies may wield such authority, as discussed previously with respect to hospitals.\textsuperscript{205} Similarly, a religious body that appoints the senior leadership or has the ability to sanction the charity may wield such influence; although, many of the existing empirical studies do not examine whether such a characteristic affects charity behavior.\textsuperscript{206}

Individuals other than donors can also serve as a restraining influence. Critical employees, such as the doctors at a hospital or the faculty at a school, may be able to prevent a charity from moving away from providing public benefit. For example, when the leaders of the Baptist Health System in Alabama sought to sell the system to a for-profit company, the hospital's doctors revolted, eventually forcing out those leaders and causing the rescission of the sale.\textsuperscript{207} Similarly, faculty who are protected by tenure and academic freedom have at times successfully challenged college and university leaders, including with respect to perceived departures from the stated public-benefitting mission of their school.\textsuperscript{208}

\textsuperscript{204} See COLOMBO \\& HALL, supra note 13, at 113 (observing that "donations constitute a signal by the donors that some good or service is undersupplied by both the private market and direct government funding").

\textsuperscript{205} See supra note 192 and text accompanying notes 189–192.

\textsuperscript{206} See supra note 194–195 and accompanying text.

\textsuperscript{207} See Michael Romano, Ch-ch-ch-changes; Baptist Health Announces Restructuring Plan, MODERN HEALTHCARE, Mar. 8, 2004, at 24; Anna Velasco, Baptist Sale Called Off: Health System Plans Restructuring as CEO Fired; Board Chair, Others Quit, BIRMINGHAM NEWS, July 13, 2003, at News.

One set of individuals that is usually relied upon to provide a balancing influence, and which appears to have had limited success in this area, is the board members and senior management of charities. Dana Brakman Reiser has argued that group governance provided by, at a minimum, a sufficiently large number of independent governing body members can ensure that a charity stays true to its public-benefit-providing mission.\footnote{Reiser, supra note 50, at 15-16, 43 (citing Dana Brakman Reiser, Director Independence in the Independent Sector, 76 FORDHAM L. REV. 795, 830 (2007) [hereinafter Reiser, Director Independence]); see also Reiser, Director Independence, supra, at 806-07 (suggesting ways in which independent directors might improve nonprofit organization governance).}

It is not clear that such reliance is justified, however, absent those individuals having some source of authority other than simply their positions.\footnote{See supra note 136 and accompanying text.} The reason for this apparent weakness may be that whatever legal authority such individuals have, it is insufficient in many, if not most, instances to counter the financial influence that consumers wield given that these leaders are also responsible for the financial well-being of the charity (in contrast to third parties such as accreditation agencies, which usually do not have that financial responsibility). Absent, therefore, some source of financial influence—such as control over a significant endowment—even independent board members may find themselves unable to resist consumer desires. There is evidence, however, that certain "good governance" practices, including having a more independent board of directors, may lead to some improvements at charities, such as improved accuracy of financial reporting.\footnote{See Michelle H. Yetman & Robert J. Yetman, The Effects of Governance on the Financial Reporting Quality of Nonprofit Organizations 10-11, 37-38 (Feb. 19, 2011) (unpublished manuscript), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1590961.}

Given the existence of these other sources of influence and the variation in their strengths and availability, a single blanket rule seeking to balance interests is not available. Rather, when it is demonstrated both that a private-benefit-seeking consumer influence is present and that influence has at least a strong potential to significantly change a charity’s activities, consideration should be given on an industry-by-industry basis to whether specific steps should be taken to enhance other influences. Arguably that is what the IRS did when it required hospitals to have both community boards and open medical staffs, enhancing the influence of community leaders and diluting the influence of specific groups of doctors (and also enhancing government influence by requiring acceptance of Medicaid and Medicare patients). That said, community boards may
often not be enough. Consideration should therefore also be given to requiring a certain minimal level of donor commitment—along the lines of Colombo and Hall’s approach but for a different reason than the one on which they primarily rely—or professional-staff or third-party involvement, when the consumer-influence risk exists.

Similarly, while the accumulation of substantial endowments has recently been the subject of significant criticism, consideration should be given to whether such endowments provide school board members and other leaders with the ability to resist demands from students/parents, for-profit licensees and joint-venture partners, and even alums that may be inconsistent with the public-benefit-seeking mission of the school. Finally, ways of increasing the involvement of other parties that are likely to reinforce the pursuit of public benefit should be considered. One specific way to increase that involvement may be to provide such parties with more information regarding the activities and priorities of vulnerable charities. The next Section addresses this possible approach in more detail.

C. Monitoring Consumer Influence

Consumer, private-benefit-seeking influence could be countered at least in part by increasing public disclosure of charity activities. Disclosure has the advantage of not putting the government in the position of dictating any particular activities or manner of providing public benefit, at least not until specific problems are revealed; although, it can create pressure to adopt certain practices. Disclosure can also be targeted, either to particular types of charities—as illustrated by the recently developed hospital schedule for the annually required tax-exempt organization information return (IRS Form 990)—or to charities that exceed a certain percentage of their revenues coming from fees for services. The administrative burden created by increased disclosure requirements therefore need not be imposed on all charities, but only a subset that is deemed to more likely be subject to adverse consumer influence.

Disclosure also has the advantage of making information available to a broad range of audiences that can then judge whether a charity has succumbed to consumer influence (or, indeed, any other adverse influences). If Congress or the IRS made such increased

212. See, e.g., Brier, supra note 136, at 37–38.
disclosure a feature of the IRS Form 990 filed by most charities of significant size, then such information would be public not only by operation of law but also because of the efforts of a private charity that provides access to all such forms online for free.\textsuperscript{214} The returns are therefore readily available not only to the IRS but also to donors, the media, state tax authorities and legislators, and the public generally. Each one of these outside influences could then call the charity to account in various ways—whether by ending financial or service support, running critical press stories, challenging state tax exemptions, or otherwise—if the perceived activities appear inconsistent with providing public benefit.

There are at least two significant problems with this approach, however, even assuming that any increased administrative burden would not be significant and that the required disclosure is correctly designed to elicit accurate and useful information.\textsuperscript{215} First, not all reviewers of this information would seek to ensure that charities only provide public benefit. The media is understandably driven by its own consumer demands, including for sensationalist stories, that might lead it to concentrate on certain details—alleged excessive compensation being a popular candidate—to the exclusion of other, less headline-inducing but perhaps more serious concerns, such as the elimination of certain medical services for which a charity is the only source in a community. Perhaps of greater concern, opponents of a particular charity’s mission might mine such disclosures for information that could be used to criticize a charity unfairly.

Second, and likely more importantly, disclosure itself is not necessarily a panacea. As those who have considered the benefits and costs of disclosure have long known, disclosure of information is not automatically beneficial. Rather, the benefits of disclosure depend on what information is disclosed and how that information is disclosed. This is the case because the effects of such disclosure on the parties making it and the utility of such disclosure to the intended audiences depend both on the usefulness of the information to that audience and whether the information is presented in such a fashion that it reaches


\textsuperscript{215} But see Dana Brakman Reiser, \textit{There Ought to Be a Law: The Disclosure Focus of Recent Legislative Proposals for Nonprofit Reform}, 80 CHI.-KENT L. REV. 559, 583–97 (2005) (expressing concerns that high implementation costs would render certain disclosure-related proposals unduly burdensome and would not improve the accuracy of disclosed information even if implemented).
that audience in an understandable manner.\footnote{See id. at 598–605 (questioning whether either public or private enforcement would be enhanced by certain disclosure-related proposals). \textit{See generally} ARCHON FUND ET AL., FULL DISCLOSURE: THE PERILS AND PROMISE OF TRANSPARENCY 11 (2007) (concluding that effective disclosure depends on transparency policies that are user-centered and sustainable).} Consideration therefore needs to be given to not only what specific information is collected but how that information is then made available to government agencies and to the public.\footnote{See Reiser, \textit{supra} note 215, at 607–08 (recognizing electronic filing as a more useful way to disclose information).} While the charity-owned GuideStar website, which posts the annual IRS filings for all tax-exempt organizations, is a great resource, it is not clear to what extent even savvy information gatherers, such as reporters, use this database, much less the average member of the public.\footnote{See, e.g., 2009 \textit{GUIDESTAR}, 2009 ANNUAL REPORT 1 (2010), available at http://www2.guidestar.org/ViewCmsFile.aspx?ContentID=3092 (reporting only 307,000 subscribers for its free newsletter).} Similarly, the various private charity “rating” organizations tend to cover only a small part of the sector and reach only a small part of the public.\footnote{See, e.g., 2009 \textit{BBB Wise Giving Alliance Annual Report}, BETTER BUSINESS BUREAU http://www.bbb.org/us/2009-bbb-wise-giving-alliance-annual-report/ (last visited June 29, 2011) (indicating that the Wise Giving Alliance made “over 1,200” reports about national charities); \textit{Frequently Asked Questions}, AMERICAN INSTITUTE OF PHILANTHROPY, http://www.charitywatch.org/faq.html (last updated Apr. 5, 2011) (indicating that the American Institute of Philanthropy’s Charity Rating Guide grades “over 500 major American charities”); \textit{Overview}, CHARITY NAVIGATOR, http://www.charitynavigator.org/index.cfm?bay=content.view&cpid=628 (last visited June 29, 2011) (evaluates “over 5,000 of America’s best-known charities”).} In part for this reason, there have been calls for public or quasi-public information clearinghouses for charities. Particularly with respect to charities that rely heavily on fees for services, it may be time to develop such proposals further.

\section*{D. The Option to Avoid}

Each of the above options attempts to address the cause of the potential problem—the influence of consumers—as opposed to addressing the symptoms—the activity that departs from providing public benefit. This choice is deliberate. Attempting through new legal rules to micromanage activities directly to ensure the provision of public benefit raises at least two significant concerns. First, and as previously discussed,\footnote{See supra notes 15, 66 and accompanying text.} such micromanagement necessarily exposes the affected charities to increased government influence, which runs counter to one of the key aspects separating charities (as well as all private entities) from government entities—not being captive to the
politically popular will. Charities can, of course, choose to align themselves with the politically popular will by collaborating with governments, including through receiving government funding for activities, but that is a voluntary surrender of autonomy, not a mandate. Such choices, as well as the choice by governments to provide public funding for a particular activity, raise their own issues, but those issues are beyond the scope of this Article.

Second, such micromanagement can easily have unintended consequences that may actually reduce the public benefit provided. For example, in the retirement community context, the choice by the IRS to require a nonexpulsion policy for elderly residents to ensure their need for financial stability is met may have had the effect of charities actually imposing more rigorous financial requirements on potential residents than comparable for-profit entities because charities face the prospect of having to provide for such residents until the end of their lives, even if they become destitute.\textsuperscript{221} Similarly, a common criticism of proposed, bright-line charity-care requirements for charity hospitals is that such requirements will lead to hospitals abandoning other worthwhile and perhaps greater public-benefit-generating activities—such as community outreach efforts, the provision of low-profit or loss-generating medical services, and medical education and research—in order to free up sufficient resources to satisfy the charity-care requirement.\textsuperscript{222} There is also a risk that such a requirement imposes a maximum as well as a minimum, perhaps leading in at least some instances to an actual reduction in the amount of charity care a particular charity hospital provides. In the child care area there is significant evidence that unobserved, and hence difficult or impossible-to-mandate factors, such as the enthusiasm and dedication of staff that a nonprofit may be able to engender, affect the quality of child care provided.\textsuperscript{223} It therefore is more advisable to directly counter the influence of consumers.

\textsuperscript{221} See Rev. Rul. 72-124, 1972-1 C.B. 145; Schlesinger & Gray, supra note 75 at 383, 385 (tbl.16.1 (finding that for-profit nursing homes generally provide better access for unprofitable patients based on Medicaid admissions).

\textsuperscript{222} See Jessica Berg, Putting the Community Back into the “Community Benefit” Standard, 44 GA. L. REV. 375, 387–429 (2010) (recognizing this problem and proposing a more nuanced regulatory mandate in response).

\textsuperscript{223} See, e.g., David M. Blau, The Production of Quality in Child-Care Centers: Another Look, 4 APPLIED DEVELOPMENTAL SCI. 136, 147 (2000); Cleveland & Krashinsky, supra note 184, at 459.
CONCLUSION

Careful consideration of the various theories that seek both to explain the role of charities and to justify their receipt of significant legal benefits reveals the distinct characteristics of charities as compared to other types of organizations, including their limitation to purposes that provide public benefit, broadly speaking. Ensuring that charities have these characteristics in turn requires that charities enjoy limited autonomy from individuals and other types of organizations, including governments. Current law for the most part provides this needed but limited autonomy, carefully balancing the influence of governments, other nonprofit-sector actors, families, and market actors. In one key respect, however, current law fails, as it does not adequately restrain the potential adverse influence of consumers on charities that rely heavily on fees for services. While several options exist for remedying this gap in existing law, choosing the correct option for any given charity activity or specific charity requires careful consideration of whether this potential adverse influence is likely to be realized.

There are several further avenues for research that these conclusions suggest. First, the existing empirical research relating to charities that rely heavily on fees for service and whether they in fact operate differently than their for-profit counterparts needs to be systematically reviewed and supplemented as needed. Only once this is done can it be determined whether consumer influence over such charities in fact needs to be countered, and which of the various countermeasures available is most appropriate. Furthermore, such a review and expansion can test the accuracy of the theoretical assertions made here. While this Article has cited some of this research for illustrative purposes, and there has been a recent comprehensive review of such research with respect to health care and nursing home charities, further work is needed with respect to the education and child care fields and with the risk of consumer influence specifically in mind.224

Second, the analysis of existing law in Part II identified several other situations where gaps may exist in current legal protections of charity autonomy or, alternatively, where protection may exist that is not necessary. These situations involved the influence of controlling family members, of controlling mutual benefit nonprofits, and of

224. See Schlesinger & Gray, supra note 75, at 378 (identifying more than 210 empirical studies comparing performance of for-profit and nonprofit hospitals, nursing homes, and managed-care organizations).
commercial fundraisers, as well as the possible unnecessary limitations on lobbying by charities. While each of these concerns is relatively minor as compared to the more significant concern of consumer influence, they are still deserving of greater scrutiny and consideration.

Third and less directly on point, there is evidence indicating that both government and the market can effectively “crowd out” charities when the previously identified government and market failures lessen or disappear. If such an ability can be confirmed empirically, then the laws setting the boundaries between charities on one hand and the government and the market on the other hand are primarily needed not to keep charities out of these other sectors but to protect charities from the influence of actors in those other sectors. Such research could also identify situations where the law may inadvertently hamper the ability of governments or the market to step into areas of weakening government or market failures.

While balancing various influences correctly is difficult, it will often be more politically feasible and effective to engage in such balancing instead of trying to simply prohibit a particular source of influence. That certainly appears to be true with respect to most charities that rely heavily on fees for services, for which the solution in the vast majority of situations should not be to prohibit such reliance but to offset whatever negative influence such reliance grants to consumers. By doing so, we can reduce or eliminate the harm that consumers of such services otherwise cause to charities and their public-benefitting missions without unnecessarily ending the provision of needed legal benefits to current charities that are in fact providing significant public benefit.

225. See supra notes 67, 76–77 and accompanying text.

226. See, e.g., Hallstrom, supra note 76, at 665–66 (describing how a legislative change that permitted student-loan charities to convert to for-profit status without having to repay back taxes on previously issued tax-exempt bonds opened the door to such conversions).