PHILANTHROPY AND PUBLIC POLICY

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A major problem of our times is to formulate a public policy for philanthropy that will ensure freedom for voluntary action consistent with the need for public accountability. Philanthropy and government both have "welfare" objectives, and increasingly they find their operations overlapping. A combination of prosperity, high tax rates and a liberal tax deduction allowance may further increase the number and importance of philanthropic organizations, but governmental welfare expenditures are also expected to rise, and perhaps at a faster rate. In the past decade, the expansion of private and public welfare activity has prompted many private, State and federal officials to reexamine the purposes and methods of philanthropy, and nowhere has this search been more intensive than in the Congress.

The term "philanthropy" is the current popular choice to describe what the law has long known as "charity." The latter is now avoided by many organizations because of its connotation of almsgiving. Similarly, the prestigeful term "foundation" has tended to displace the more pedestrian legal terms trust and corporation. A foundation has been defined as a "nongovernmental, nonprofit organization having a principal fund of its own, managed by its own trustees or directors, and established to maintain or aid social, educational, charitable, religious or other activities serving the common welfare."[1] Under this definition, there are some 5,000 foundations—27 in 1915, 188 in 1939, 899 in 1948—with assets of $5 billion and annual expenditures of $300-$400 million. Another definition is "any body that is legally chartered or that is created through a charitable trust statute, the purpose of which is to channel private wealth into general welfare channels."[2]

The Internal Revenue Code does not define the term, and attempts no distinction between a "foundation" and other organizations that qualify for exemption under section 501(c)(3):

> "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 for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on of propaganda, or otherwise attempting, to influence legislation, and which does not par-

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[1] ANDREWS, PHILANTHROPIC FOUNDATIONS 11 (1956).

[2] *Hearings Before the Select Committee to Investigate Tax-Exempt Foundations and Comparable Organizations of the House of Representatives,* 82d Cong., 2d Sess., at p. 13 (1952).

ticipate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office."

Philanthropy is only one of 16 categories exempted from the income tax, which include such not-for-profit organizations as labor unions, chambers of commerce, cooperatives, and the like. But it is unique in that a contributor to an organization of the philanthropic class enjoys a liberal deductible allowance in computing his income tax liability. The size of the class has grown rapidly from 12,500 in 1939, 27,500 in 1946, 32,000 in 1950, and by now has probably passed the 40,000 mark. This phenomenal growth has occurred without any major statutory changes in the composition of the class. Religious, charitable, educational and scientific organizations have been exempt in all revenue acts since the 1913 enactment. The prevention of cruelty to children and animals was made a permissible purpose in 1918, literary purposes qualified in 1921, and testing for public safety in 1954.

The Congress has been uncommonly reticent in offering precise definitions of the types or purposes of eligible organizations. The details have been left to the courts, which, under a rule of liberal construction, have tended to assist the expansion of the class. It includes organizations of all major religious faiths; colleges and universities; hospitals; subscription charities, such as as those that conduct annual disease drives; the highly publicized foundations which operate under broad charters in research and education; and a host of entities that serve as little more than the philanthropic pocketbooks of individuals, families and business firms.

Congressional interest has been directed toward two aspects of philanthropic operations. Tax-writing committees have viewed them primarily as economic beings. To the extent that an exempt organization has a capital fund of its own, it is part of the general stream of investment capital and participates in economic processes. It is an element in the market, apart from whatever else it might be, and in that respect it occupies a role in society not unlike that of a business firm.[3] Although it is a long-standing policy of the Congress to encourage philanthropic giving by permitting the diversion of funds from tax to philanthropic channels, the use of the conduit as an instrument of business manipulation has been frowned upon, on the theory that the tax exemption should not be sold or otherwise be used to achieve a competitive advantage in the market place. Loss of tax revenue has not been a decisive consideration. Following highly publicized disclosures of a blurring of the line between philanthropy and the business world, the Revenue Act of 1950 set forth the general principle that the philanthropic end does not justify the business means used to achieve it. Thus, the "unrelated business income" of an exempt organization is now taxable; the strange phe-

[3] See Sen. Comm. on Banking and Currency Staff Report, *Institutional Investors and the Stock Market, 1953-55,* Committee Print, 84th Cong., 2d Sess.

nomenon of the "leaseback" was circumscribed with a set of rules to discourage the sale of an exemption; a series of "prohibited transactions" was itemized in order to elaborate the meaning of the language of the exemption section that forbids the inurement of exempt earnings to a private individual or shareholder; and "unreasonable" or improper accumulations of income were prohibited in an effort to break the bottleneck created when, for business purposes, exempt income is delayed in reaching its philanthropic destination. However, in view of the continuing proliferation of exempt organizations, the principle that the end does not justify the means may prove increasingly more difficult to apply, and the question of the relationship of philanthropy and business is probably far from settled.

The second aspect relates to philanthropic purposes, which are specified in the tax statute but which raise fundamental policy problems when the federal government seeks to limit their nature and scope. With few exceptions, philanthropic organizations are creatures of the states, which have the primary responsibility for policing their operations. Although some states in recent years have awakened to their responsibilities, nothing they have done so far has had an impact on the philanthropic world equal to the nationwide influence of the *ad hoc* Congressional committee investigations of 1952[4] and 1954.[5] Limited by time, funds, a dearth of systematic data, an edgy social and political environment, and lacking the experience and discipline of a standing committee with legislative as well as investigative responsibilities, the committees that have been created, for one reason or another, to scrutinize the purposes of philanthropic organizations have produced inconclusive results. The permissible purposes and the limitations set forth in the statute are too general and ill-defined to serve as a guide. The four stated limitations are especially troublesome. The first two appeared in the 1913 enactment. The first test requires that an exempt organization be "organized and operated exclusively" for a permissible purpose—a test that has been used to deny exemption to organizations alleged to be engaging in so-called subversive activities. The second test is that "no part of the net earnings . . . inures to the benefit of any private shareholder or individual;" this is a traditional criterion for distinguishing a charitable from a private trust. The third and fourth tests are indigenous American creatures spawned during an era when the increasing overlap of philanthropic and governmental operations is viewed by some observors as an overlap, in certain types of activity, of philanthropy and political activity. The "propaganda" clause first appeared in the Revenue Act of 1934, and it is especially pertinent as a test involving organizations seeking exemption as

[4] Hearings, *supra* note 2.

[5] *Hearings Before the Special Committee to Investigate Tax-Exempt Foundations and Comparable Organizations of the House of Representatives*, 83d Cong., 2d Sess. (1954).

educational, but which conduct their educational activities outside the framework of a regularly established school such as a college or university. Without the protection society usually accords campus activity, such an educational organization is at times vulnerable to charges of propagandizing or lobbying. The fourth limitation was adopted as a Senate floor amendment in 1954 as an absolute bar to "political" campaigning and is not controlled by the "substantial" test in the third limitation relating to propaganda to influence legislation.

Given an obsolescent statute which the courts have had too little occasion to clarify, and permission from the House to probe "un-American and subversive activities," it was probably inevitable that the two recent inquiries should gravitate toward the larger "foundation." These organizations—7 each have assets of $100 million or more; another 70 each have $10 million or more—have a number of distinguishing characteristics. Their charters generally are drawn to permit them to engage in a range of activities broad enough to encompass several of the purposes in the exemption section, in marked contrast to the charitable trust instrument of earlier years which usually stated a limited and detailed purpose. The general purpose foundation is a modern American development of the last half century. Most large foundations also distinguish themselves from other philanthropic organizations in the use of their resources as "venture capital," that is, they seek, largely through research and education, to discover and apply new knowledge toward the end of preventing undesirable physical, social, and allied ailments of mankind, rather than to apply their funds to some form of limited cure, which, they say, should be provided by other private organizations or by government. This approach to philanthropy requires a long-range perspective and continuous study of the needs of mankind and of the methods that can best be employed to meet them. In many respects, general purpose foundations are akin to universities, and a major share of their grants is used within institutions of higher learning, but the managers of philanthropic funds are legally and administratively detached from, and to some degree in competition with, university administrators. In addition to purpose and method, size is a factor to the extent that some minimum is needed to afford managerial talent, although a small organization can pool its resources with others in a community trust or foundation.

Congressional investigations have been directed primarily at the large organizations that grant or use funds in the social sciences and education. The physical and biological sciences, presumably because they are "exact" sciences, and religion, because of other reasons, have not played an important part in Congressional probes, except in so far as operations in these areas were cited by foundation witnesses as examples of the successful and beneficial use of tax-exempt funds. But in venturing into the social studies, where the search for truth often leads to findings that influence public opinion and, in turn, legislation, the larger

exempt organizations have aroused controversy. The majority report of the first Congressional investigation, in 1915, which arose out of a Rockefeller Foundation proposal to investigate industrial relations at a time when a Rockefeller-owned corporation was contending with a strike, concluded that foundations were a menace to the nation's welfare because of their reactionary and conservative outlook, and recommended that limitations be placed on the size, income, and life of foundations with over one million dollars in assets, and that the federal government should increase its appropriations for education and social welfare.[6] The second major investigation was conducted by a House Select Committee, in 1952, which, along with several other committees, was concerned about "un-American and subversive activities." A unanimous report concluded that exempt organizations had not used their resources to discredit or undermine the capitalistic system and that "on balance the record of the foundations is good,"[7] but one of the members felt that there had been too little time for the size of the job, and he became the chairman of a similar investigation in the 83d Congress. He also broadened the scope of inquiry, asking not only whether foundations and comparable organizations were using their funds for "un-American and subversive activities," as the 1952 Committee had, but also "for political purposes; propaganda, or attempts to influence legislation." In a way, this was more closely related to the issues posed in the exemption provisions of the Code. But the staff work was too diffuse and the hearings too voluble to produce any systematic finding, and the result was a stalemate. Of the five members, three signed a majority report which was highly critical of foundations, especially of their activity in the social sciences and education, but one of the signatories filed a separate statement virtually reaffirming the unanimous findings of the 1952 Committee, of which he had been a minority member, which praised foundations. The minority members dissented on both substantive and procedural grounds. Throughout the hearings, the ranking minority member, Representative Wayne L. Hays, of Ohio, challenged the investigative methods employed, particularly by the staff, and one of the effects of this challenge was to bring into sharper focus the policy problem created when government asserts its power of surveillance over the end product of philanthropic operations, which is often an intellectual product.

The crux of the policy issue is pointed up by an observation, in the majority report of the 1954 House investigation, that the trustees of a philanthropic organization should "be very chary of promoting ideas, concepts and opinion-forming material which run contrary to what the public currently wishes, approves and likes."[8] This is a public relations

[6] Sen. Doc. No. 415, 64th Cong., 1st Sess. (1916).

[7] H. R. Rep. No. 2514, 82d Cong., 2d Sess., 8 (1953).

[8] H. R. Rep. No. 2681, 83d Cong., 2d Sess., 20 (1954).

test that is still relatively far removed from existing public policy. Its implementation would require regulatory machinery and methods foreign to the American tradition of freedom of thought and inquiry. The effect of well-publicized Congressional hearings, however, can be a form of regulation. Similarly, although the Exempt Organizations Branch of the Internal Revenue Service was not established as a regulatory agency, it must decide the question of legitimacy when an organization applies for exemption as an educational organization, and it must continue to make such decisions largely on the basis of complaints, information returns, and the findings of what limited review it can make of many thousands of organizations that now have exempt status. Since the product of an educational organization is an intellectual product, an administrative decision on an application or in reviewing the performance of an educational organization is a form of intellectual surveillance. And the more thorough the scrutiny, the closer an executive agency moves toward the role of censor, especially if the exempt organization could not survive without the tax benefit or the public status accorded a philanthropy.

The regulations covering the activities of educational organizations shed little light on the policy direction of the statute, for they tend to move in two opposite directions. In 1953, an educational organization, according to the regulations, would lose its exemption if its principal purpose and substantially all of its activities were not "clearly of a nonpartisan, noncontroversial and educational nature." By 1956, the notion that controversy and education are incompatible was dropped. This change was in itself a significant contribution to freedom of inquiry. But as if in anticipation of the growing number of applications for exemption that require hard choices, the regulations attempt to distinguish education from propaganda, and to suggest some meaning for the statutory proscriptions of "to influence legislation" and "political" activities. An educational activity is one designed to "disseminate knowledge and basic factual information rather than unsupported opinion," and requires a "fair presentation of pertinent factual material." On the other hand, propaganda presents "but one side of an issue," and although it is not proscribed as such, it is if it attempts "to influence legislation."

It is the supreme irony that an ancient and unresolved philosophical dispute as to what is knowledge and what is opinion should have to be settled by an administrative agency just as it acquired the philosophical insight that education and controversy are not incompatible. The administrative morass that results from the propaganda clause was forecast by Senator Robert La Follette during debate on the 1934 statute. The accusation of lobbying by philanthropic organizations led to the statutory proscription of propaganda to influence legislation, but the remedy, as he saw it, was to eliminate entirely the charitable deduction for income tax purposes. Of course, the proposed regulations follow generally the

guidelines drawn by court decisions, which reflect the same quandary evident in the regulations and the basic statute.[9]

Voluntary action and public accountability in the realm of philanthropy are complementary, but are in serious imbalance because of the absence of a clear policy and a federal system of public accountability. Congressional policy now encourages philanthropy through liberal exemption and deduction privileges, lays gentle hands on the cord that binds philanthropy to the business community, has fostered a jurisdictional separation between inquiries into methods and inquiries into purposes and leaves the rest to the executive branch, the courts, the states and voluntary effort. But the dynamics of the social and economic changes that have produced an unprecedented number of exempt organizations have tended to obscure or erode federal policy and to create a need for reformulation.

One omen of Congressional policy direction is discernible in the Code. For income tax purposes, after 1954, an individual is permitted a charitable deduction up to 30 percent, if at least ten percent is contributed to religious organizations, schools or hospitals; for contributions to the rest of the exempt class, a contributor is limited to 20 percent. The 30 percent class includes widely recognized and readily acceptable institutional forms and practices. The 20 percent class includes a bewildering variety of forms and practices which the public associates with the rapidly growing foundation movement and which have not as yet achieved an identity that is widely accepted or understood. This is the only instance in which an increase in the deductible allowance was not applied equally for the benefit of all philanthropic organizations. The basis for such a principle of selection, however, was laid down as early as 1943, when the reporting requirements for exempt organizations were set down but not imposed on religious and educational institutions. The characterization of an educational organization is especially significant, in the light of the controversy that centers on the education category; it is an organization that normally has a faculty, curriculum and student body. Also excused from reporting are charitable organizations, and organizations for the prevention of cruelty to children or animals, if supported by contributions from government or the general public. Comparable categorizations are manifest in the provisions relating to prohibited transactions and the admissions tax. In short, there has been a trend in the direction of separating religious organizations, schools, hospitals and subscription charities from all other types including "foundations." The latter group is experiencing the greatest growth. Probably the most important phenomenon in the philanthropic picture today is the rapid increase of relatively small organizations created by individual, family, or company contributions out of a variety of business and philanthropic motives. Thus, the section 501(c)(3) class may be de-

[9] 42 A.B.A. Journal 773-5 (1956).

veloping a new pattern of subsidiary classes which would warrant different policy approaches.

The scant evidence now available is strongly suggestive of the need for eventual overhaul of the exemption provisions as the best long range approach to the reformulation of policy. But in the meantime, legislative change should be based on comprehensive information, which is not now available. The most efficient method of gathering data is through the use of existing administrative machinery of the Internal Revenue Service. At least two modifications would be needed. First, the scope of the information now required by the Internal Revenue Service should be broadened to include more detail on administrative expenses and on the characteristics of grants and grantees. This would be accomplished in part by bills now pending before the House Committee on Ways and Means,[10] and sponsored by the ranking majority and minority members of the 1952 investigating committee which suggested the amendment. Second, the returns, now decentralized in district offices, should be brought together in one place to serve as the start of a national registry. A Congressional policy for philanthropy should be a national policy; it is not a regional or local problem. The states and private organizations should not fear the public policy that would result from a thorough public discussion based upon full disclosure. In the Congress, the task should be undertaken by the standing committees responsible for tax matters. The Congress should recognize the fact that the ends and means of philanthropic operations are largely inseparable. The best long-run assurance against governmental encroachment is to recognize at the outset that knowledge and discussion are the indispensable prerequisites to sound public policy formulation, which, in turn, is one of the main components of effective and responsible voluntary action in the field of philanthropy.

[10] H. R. 3234, and H. R. 3253, 85th Cong., 1st Sess. (1957).