Articles

WHY IS HARVARD TAX-EXEMPT?
(AND OTHER MYSTERIES OF TAX EXEMPTION
FOR PRIVATE EDUCATIONAL INSTITUTIONS)

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I. INTRODUCTION

Why is Harvard tax-exempt? Better yet, why do entities offering continuing legal education for lawyers and seminar training for bankers (who probably are not anyone's first choice as groups in need of charity) qualify as tax-exempt educational organizations? The issue of tax exemption for private educational institutions[1] is certainly a curious one. Many private educational institutions, after all, "sell" education much the same way Microsoft sells software,[2] and their "customers" (students) certainly pay for the product.[3] In fact, recent data indicates that more than 60% of the annual gross revenues of private universities came from student tuition and sales.[4] Yet while no one would suggest that we give Microsoft an exemption from federal and state income, property and other taxes,[5] tax exemption for private educational institutions has been virtu-

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1. This Article deals with the rationales for exempting private educational institutions only. Government institutions, such as state universities and local public schools, are also tax-exempt, but the explanation for such exemption is simple: it doesn't make much sense for the government to tax itself. Admittedly, most public universities charge significant tuition. In fact, 1990 data showed that some 37% of the revenue of public universities came from tuition and fees (15.5%) and other sales (21.7%). NATIONAL CTR. FOR EDUC. STATISTICS, CURRENT FUND REVENUES AND EXPENDITURES OF INSTITUTIONS OF HIGHER EDUCATION: FISCAL YEARS 1982–1990 (1992) [hereinafter CURRENT FUND REVENUES]; see LESTER M. SALAMON, AMERICA'S NONPROFIT SECTOR: A PRIMER 74 (1992). Nevertheless, since these tuition funds are going to a government institution, one can appropriately view tuition as a sort of incremental tax on persons using government educational institutions. In modern tax parlance, the Treasury might well refer to this as a "user fee" to avoid the dreaded "tax" label.
2. While I have yet to see Harvard advertise at half-time of the Superbowl, the slick brochures put out by virtually every private educational institution rival those I have received in the mail from Microsoft touting the latest version of their Windows software. One recently-formed private nonsectarian elementary school in Champaign, Illinois, advertised for students in the local newspaper. CHAMPAIGN–URBANA NEWS–GAZETTE, June 20, 1993, at 14 (ad for Countryside School). Daniel Levy noted the trend in 1986: "Many private colleges and universities have taken to increasingly direct invidious comparisons with competitors (private and public), while even public counterparts sell themselves through media and other campaigns in ways once thought unbecoming. The same can now be said of many private schools as they launch major media efforts, often drawing on seminars run by for-profit concerns." Daniel C. Levy, *Private Choice and Public Policy in Nonprofit Education, in* PRIVATE EDUCATION: STUDIES IN CHOICE AND PUBLIC POLICY 18 (Daniel C. Levy ed., 1986).
3. According to latest college handbooks, the tab for four years at Harvard runs approximately $94,000, including annual tuition of $17,674 and annual room and board charges of $5840. PETERSON'S INDEX TO FOUR-YEAR COLLEGES 1994, at 522 (24th ed. 1993).
4. CURRENT FUND REVENUES, *supra* note 1, at 14, tbl. 7 (38.9% from tuition and fees; 22.9% from sales and services); SALAMON, *supra* note 1, at 76. See *infra* appendix, table 2 and text accompanying notes 217–39, for a discussion of donations as a percentage of education and general revenues in higher education.
5. While the most widely-discussed source of tax-exemption is the Internal Revenue Code, I.R.C. § 501(c)(3) (1986), which grants certain religious, educational and charitable

ally unquestioned since colonial times and remains so. In fact, the major articles examining the scope of tax exemption for charitable and other institutions, all written within the past two decades, pay only passing attention to educational institutions.[6]

This Article examines the exemption for private educational institutions in light of the rationales advanced to justify tax exemption for charitable institutions in general, with emphasis on the donative rationale that Professor Mark Hall and I have proposed in prior articles. I begin with a historical survey of the exemption and summary of the current standards for exemption at the federal and state levels. This section of the Article criticizes both the expansive definition of "education" and the tools used by the IRS and state taxing authorities to circumscribe this definition. I then proceed to an explanation of the various theories of exemption and an analysis of whether those theories support a logical definition of the exemption. After examining data on the importance of donations to various kinds of educational institutions, the Article concludes that the donative theory, which would limit exemption to those entities that obtain a certain percentage of revenues from donations, provides the most defensible scope of exemption for private educational institutions.

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institutions exemption from the federal income tax, state property tax exemption is often equally, if not more, important to an organization as income tax exemption. The reason for this is that many tax-exempt institutions may have no net income for the year (if expenses equal receipts, for example), but virtually every tax-exempt entity owns otherwise-taxable property. *See* John G. Simon, *The Tax Treatment of Nonprofit Organizations: A Review of Federal and State Policies, in* THE NONPROFIT SECTOR: A RESEARCH HANDBOOK 67, 81 (Walter W. Powell ed., 1987) (income tax exemption would result in minimal consequences to most exempt entities, but state property tax exemption likely is a significant financial benefit).

Meeting the standards of federal income tax exemption under § 501(c)(3), however, nevertheless may be vital since these standards essentially are the same as those required to qualify an organization to receive tax-deductible contributions. I.R.C. § 170(c) (1986). While the income tax system would not necessarily have to tie the deductibility of contributions to exemption standards (that is, the law could permit deductible contributions to non-exempt entities), this is not how the system currently works.

States often do give for-profit businesses exemption from property taxes as an incentive for locating in a particular geographic area, but these incentive exemptions usually are of limited duration and aimed at a specific business, rather than structural in nature. Such ad-hoc decision making is not the subject of this Article.

6. While any attempt to catalogue major works in an area leaves one open to the wrath of the unincluded, in the field of legal scholarship, Boris I. Bittker and George K. Rahdert's 1976 article *The Exemption of Nonprofit Organizations from Federal Income Taxation*, 85 YALE L.J. 299 (1976), was the first comprehensive examination of the *federal income* tax exemption. They devote about two pages of their sixty page article to educational institutions. Bittker and Rahdert's work was essentially the only piece in the field until the 1980s, when Henry B. Hansmann explored the scope of the federal income tax exemption in two related articles, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835 (1980) [hereinafter Hansmann I], and *The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation*, 91 YALE L.J. 54 (1981) [hereinafter Hansmann II]. In these two articles spanning some 110 pages, Professor Hansmann spends about one page specifically discussing educational institutions.

More recently, Professor Atkinson's work on altruism and my own works with Professor Mark Hall have added to the literature. Professor Atkinson spends about two pages discussing altruism in education, Rob Atkinson, *Altruism in Nonprofit Organizations*, 31 B.C. L. REV. 501, 541–42 (1990); Professor Hall and I confine educational institutions to a couple of footnotes in more than 200 pages. Mark A. Hall & John D. Colombo, *The Donative Theory of the Charitable Tax Exemption*, 52 OHIO ST. L.J. 1379, 1455 n.229 (1991).

Of course, major works on nonprofit enterprise in other fields, notably economics, have paid more serious attention to educational institutions. *See, e.g.*, Marc Bendick, Jr., *Education as a Three-Sector Industry, in* THE VOLUNTARY NONPROFIT SECTOR 101 (Burton A. Weisbrod ed., 1977).

II. BACKGROUND: THE HISTORY OF TAX EXEMPTION FOR PRIVATE EDUCATIONAL INSTITUTIONS

Tax exemption for private educational institutions extends to the beginning of colonial America.[7] Indeed, the seeds of tax exemption for private schools can be traced to Fourteenth Century England, where William Langland wrote in the poem *Piers the Plowman* that in order to save their souls, wealthy merchants should devote their fortunes to "repair hospitals[,] help sick people[,] mend bad roads[,] build up bridges that had been broken down[,] help maidens to marry or to make them nuns[,] find food for prisoners and poor people[,] *put scholars to school or to some other crafts*[,] help religious orders, and ameliorate rents or taxes."[8] The preamble to the English Statute of Charitable Uses enacted in 1601 also recognized the charitable nature of "schools of learning, free schools and scholars in universities ...."[9]

In colonial America, religious and educational institutions were exempted from local taxes from the beginning.[10] In fact, several colonies even extended local tax exemption to the professors who taught in colleges or universities as well as their students.[11] The educational exemption appears to have been connected to the historic exemption for churches and religious institutions, since virtually all educational institutions of the time had the training of

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7. John P. Persons et al., *Criteria for Exemption Under Section 501(c)(3), in* RESEARCH PAPERS SPONSORED BY THE COMMISSION ON PRIVATE PHILANTHROPY AND PUBLIC NEEDS 1909, 1923 (U.S. Dep't of the Treasury ed., 1977); Chauncey Belknap, *The Federal Income Tax Exemption of Charitable Organizations: Its History and Underlying Policy, in* RESEARCH PAPERS SPONSORED BY THE COMMISSION ON PRIVATE PHILANTHROPY AND PUBLIC NEEDS 2025, 2028–29 (U.S. Dep't of the Treasury ed., 1977); William R. Ginsberg, *The Real Property Tax Exemption of Nonprofit Organizations: A Perspective,* 53 TEMPLE L.Q. 291 (1980).

8. Persons et al., *supra* note 7, at 1912 (quoting the modern English version of the "B" text of the poem) (emphasis added).

9. *Id.* at 1913; *see also id.* at 1963. Interestingly, however, English law does not totally exempt charities from taxes. While charities have been exempt from income taxes in England since the first income tax act in 1842, charities are required to pay local property taxes, albeit at reduced rates (charities in England pay local property taxes at a rate half that of private businesses, although local authorities have the discretionary power to further reduce or eliminate the tax). *Id.* at 1919. *See* MICHAEL CHESTERMAN, CHARITIES, TRUSTS AND SOCIAL WELFARE 243 (1979).

10. Persons et al., *supra* note 7, at 1923; *see also* ALFRED BALK, THE FREE LIST 22–23 (1971); Belknap, *supra* note 7, at 2028–29; William R. Ginsberg, *supra* note 7, at 292; Alvin C. Warren, Jr. et al., *Property Tax Exemptions for Charitable, Educational, Religious and Governmental Institutions in Connecticut,* 4 CONN. L. REV. 181, 184–89 (1971); Walz v. Commissioner, 397 U.S. 664, 704–08 (1970).

One should note that in colonial America neither tax exemptions nor taxes themselves followed the systematic statutory regime of modern times. Often, exemptions were incorporated in corporate charters. Moreover, systems of taxation were haphazard, without uniform methods of identifying taxable property or even an annual tax collection system. *See generally* Stephen Diamond, *Of Budgets and Benevolence: Philanthropic Tax Exemptions in Nineteenth Century America, in* RATIONALES FOR FEDERAL INCOME TAX EXEMPTION 7–9 (1991) (collection of papers for the 1991 NYU Conference on Philanthropy and the Law); Carroll H. Sierk, *State Tax Exemptions of Non-Profit Organizations,* 19 CLEV. ST. L. REV. 281, 282 (1970).

11. The Massachusetts Bay Province Laws of 1706–1707, for example, provided exemption from local property and poll taxes for "the president, fellows and students of Harvard Colledge [sic]." 1706–1707 Mass. Bay Province Laws, ch. 6, § 2, *quoted in* Belknap, *supra* note 7, at 2028. Rhode Island also originally exempted the professors of Brown University from local property taxation. *Id.* at 2029. Ah, for the good old days.

ministers as a primary objective.[12] Moreover, many of these institutions began life as quasi-public schools. Harvard, for example, was chartered with a grant of public funds, as were Yale, Brown, Dartmouth and William & Mary.[13] These exemptions survived the formation of the United States, and today virtually every state has either a constitutional or statutory provision exempting educational institutions from state and local property and income taxes.[14]

At the federal level, tax exemption for schools or other charities was simply not an issue until the passage of the first income tax act in 1894. Prior to this, federal revenues came mostly from import duties and excise taxes, which did not affect the charitable organizations of that time.[15] The first federal income tax law adopted in 1894, however, contained a broad exemption for "corporations, companies or associations organized and conducted solely for charitable, religious or educational purposes."[16] As other commentators have noted, the legislative history is largely silent regarding the origins of this provision. It appears to have been completely uncontroversial, and not debated.[17] As a result, most commentators have concluded that the exemption merely recognized at the federal level the universality of the exemption at the state and local level, as well as the fact that a tax on profits should not include "nonprofit" organizations.[18] This recognition was then incorporated into subsequent tax acts: while the 1894 law was declared unconstitutional in 1895, every subsequent federal income tax law has contained a similar exemption.[19]

III. CURRENT LEGAL STANDARDS FOR EXEMPTING PRIVATE EDUCATIONAL INSTITUTIONS

A. Federal Standards For Exemption

1. Education as a Charitable Purpose

All charitable organizations must meet certain general standards for exemption under Internal Revenue Code ("Code") § 501(c)(3). These general standards include organizing documents that limit the entity's purpose and

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12.   *Id.* at 2028. Tax exemption for churches and religious institutions appears to be as old as taxes themselves. *See* Sierk, *supra* note 10, at 282 (noting that one historian had reported that the "economic equilibrium" of ancient Egypt was endangered by the fact that tax exempt temples owned 15% of the land and vast amounts of other personal property during the reign of Ramses III about 1200 B.C.); Warren et al., *supra* note 10, at 188; *Ezra* 7:24 ("It shall not be lawful to impose toll, tribute or custom upon ... priests ... or ministers of the house of God ....").

13.   Earl F. Cheit & Theodore E. Lobman, III, *Private Philanthropy and Higher Education: History, Current Impact and Public Policy Considerations, in* RESEARCH PAPERS SPONSORED BY THE COMMISSION ON PRIVATE PHILANTHROPY AND PUBLIC NEEDS, *supra* note 7, at 453–54.

14.   Persons et al., *supra* note 7, at 1923; *see also* Ginsberg, *supra* note 7, at 292; Mark A. Hall & John D. Colombo, *The Charitable Status of Nonprofit Hospitals: Toward a Donative Theory of Tax Exemption,* 66 WASH. L. REV. 307, 323–24 and sources cited therein (1991) [hereinafter Hall & Colombo II].

15.   Persons et al., *supra* note 7, at 1924.

16.   Revenue Act of 1894, ch. 349, § 32, 28 Stat. 556 (1894); *see* Persons et al., *supra* note 7, at 1924; Kenneth Liles & Cynthia Blum, *Development of the Federal Tax Treatment of Charities,* LAW & CONTEMP. PROBS., Autumn 1975, at 6.

17.   Diamond, *supra* note 10, at 36–37.

18.   Persons et al., *supra* note 7, at 1924; Belknap, *supra* note 7, at 2031.

19.   Persons et al., *supra* note 7, at 1924.

operations to a charitable purpose, such as education;[20] actual pursuit of such charitable purpose in the entity's operations;[21] an absence of "private inurement";[22] and compliance with limits on political lobbying and campaign activity.[23]

The major issue that has faced both the Internal Revenue Service (IRS) and the courts in interpreting the scope of federal tax exemption for educational institutions has been defining what constitutes "education." Unfortunately, the statutory language has never attempted to define "education" for purposes of the exemption. The Treasury Department, moreover, never has confined the exemption to traditional schools. Even as early as the 1920's, the IRS concluded that the educational exemption applied to activities as diverse as studying ruffled grouse,[24] maintaining wild bird sanctuaries and forest land,[25] and disseminating geographic knowledge.[26] This approach apparently derived from the general law of charitable trusts, which recognizes a broad range of activities as educational.[27]

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20. Treas. Reg. § 1.501(c)(3)-1(b)(1) (as amended in 1961); *see generally* BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS, ¶ 100.2 (2d ed. 1992); BRUCE R. HOPKINS, THE LAW OF TAX-EXEMPT ORGANIZATIONS 109–17 (6th ed. 1992); PAUL E. TREUSCH, TAX-EXEMPT CHARITABLE ORGANIZATIONS 90–91 (3d ed. 1988).
    21. Treas. Reg. § 1.501(c)(3)-1(c) (as amended in 1961). The regulation, however, permits a charitable entity to carry on activities unrelated to its charitable purpose as long as such activities are "insubstantial." *Id. See generally* BITTKER & LOKKEN, *supra* note 20, ¶ 100.2; HOPKINS, *supra* note 20, at 117; TREUSCH, *supra* note 20, at 101–07.
    22. I.R.C. § 501(c)(3) (1993). The private inurement limitation generally refers to the prohibition against an exempt entity diverting its economic resources from the charitable class it is supposed to serve into the hands of "insiders" such as employees, managers, directors or the like. *See* BITTKER & LOKKEN, *supra* note 20, ¶ 100.4; HOPKINS, *supra* note 20, at 264–66; TREUSCH, *supra* note 20, at 241–47. A classic example of private inurement is payment of excessive salaries to managers; for a further discussion of this concept, see *infra* text accompanying notes 52–59.
    IRS regulations define a separate, but related, concept of "private benefit," which seeks to insure that the organization operates for the benefit of the public generally, and not a few private individuals. Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) (as amended in 1961). *See infra* text accompanying notes 57–61; HOPKINS, *supra* note 20, at 297–99; TREUSCH, *supra* note 20, at 257–61.
    23. I.R.C. § 501(c)(3) (as amended in 1961); *see* Treas. Reg. §§ 1.501(c)(3)-1(c)(3), 1.501(h), 56.4911 (as amended in 1961). For general discussions of the lobbying and campaign activity prohibitions, see BITTKER & LOKKEN, *supra* note 20, ¶ 100.5; HOPKINS, *supra* note 20, at 300–51; TREUSCH, *supra* note 20, at 263–329. For an extensive scholarly review of the lobbying and campaign activity prohibitions, see Laura B. Chisolm, *Exempt Organizations Advocacy: Matching the Rules to the Rationales*, 63 IND. L.J. 201 (1987), and Laura B. Chisolm, *Politics and Charity: A Proposal for Peaceful Coexistence*, 58 GEO. WASH. L. REV. 308 (1990).
    24. I.T. 2282, 5–1 C.B. 80 (1926).
    25. I.T. 2134, 4–1 C.B. 214 (1925).
    26. I.T. 1475, 1–2 C.B. 184 (1922).
    27. *See* WILLIAM F. FRATCHER, SCOTT ON TRUSTS § 370 (1989); Treas. Reg. § 1.501(c)(3)-1(d)(2) (1993) ("Charitable" in section 501(c)(3) is used in "its generally accepted legal sense"); National Alliance v. United States, 710 F.2d 868, 873 (D.C. Cir. 1983) ("We recognize the inherently general nature of the term 'educational' and the wide range of meanings Congress may have intended to convey."); Weyl v. Commissioner, 48 F.2d 811, 812 (2d Cir. 1931) ("In the absence of a specific definition, the words are to be given their usual and accepted meaning .... 'Education' has been defined by the encyclopedia and dictionaries as 'imparting or acquisition of knowledge; mental and moral training; cultivation of the mind, feelings and manners.'"); *see also* Tommy F. Thompson, *The Availability of the Federal Educational Tax Exemption for Propaganda Organizations*, 18 U. CAL. DAVIS L. REV. 487,

The current Treasury regulations include in the definition of education "instruction or training of the individual for the purpose of improving or developing his capabilities" as well as "instruction of the public on subjects useful to the individual and beneficial to the community."[28] Within this definition fall "schools" as one might colloquially think of them: institutions with a regularly scheduled curriculum, a regular faculty and a regularly enrolled body of students, including primary and secondary schools, colleges, professional schools and trade schools.[29] The definition, however, also extends to a number of entities that one would not immediately classify as educational institutions, such as entities presenting public discussion groups, forums, panels or lectures, entities providing correspondence courses through radio or television, and "museums, zoos, planetariums, symphony orchestras, and other similar organizations."[30] The educational exemption also has been applied to organizations that provided continuing legal education and other professional skills training,[31] university bookstores,[32] a jazz festival,[33] various counseling services,[34] research organizations,[35] and a number of organizations whose stated purpose was to disseminate information to the public.[36] Even the IRS, however, has its limits: a dog obedience school was held not exempt since it neither trains individuals nor educates the public.[37]

2. Limitations on the Definition

The breadth of the federal tax definition of an "educational institution" has resulted in numerous problems for both the IRS and the courts in drawing the line between exempt and non-exempt institutions. One has the intuitive sense, for example, that "McDonald's U" ought not to receive tax exemption given that its sole purpose is to teach McDonald's employees the art of hamburger making and serving. Nevertheless, such an institution arguably falls within the "instruction or training of the individual" part of the 501(c)(3) definition of education. Another perennial problem for the IRS has been the perceived need to distinguish between educational institutions and "propaganda"

496, 513 (1985).

28. Treas. Reg. § 1.501(c)(3)–1(d)(3)·(as amended in 1961).
29. Treas. Reg. § 1.501(c)(3)–1(d)(3)(ii), example 1.
30. Treas. Reg. § 1.501(c)(3)–1(d)(3)(ii), examples 2–4.
31. *E.g.*, Kentucky Bar Found. v. Commissioner, 78 T.C. 921, 924 (1982) (IRS conceded continuing legal education was an educational activity entitled to exemption); Rev. Rul. 74–16, 1974–1 C.B. 126 (managing credit unions); Rev. Rul. 65–298, 1965–2 C.B. 163 (update seminars for physicians); Rev. Rul. 68–504, 1968–2 C.B. 211 (banking).
32. Rev. Rul. 69–538, 1969–2 C.B. 116 (bookstore operated on a cooperative system, refunding excess earnings to students and faculty members in proportion to patronage).
33. Rev. Rul. 65–271, 1965–2 C.B. 161.
34. Rev. Rul. 70–640, 1970–2 C.B. 117 (marriage counseling); Rev. Rul. 69–441, 1969–2 C.B. 115 (personal financial counseling); Rev. Rul. 73–569, 1973–2 C.B. 178 (counseling women on resolving unwanted pregnancies); Rev. Rul. 78–99, 1978–1 C.B. 152 (counseling for widows and widowers); Rev. Rul. 74–595, 1974–2 C.B. 164 (counseling men on sterilization methods).
35. *E.g.*, Rev. Rul. 67–4, 1967–1 C.B. 121 (research and dissemination of information on medical and physical disorders). There are countless others. *See generally* BITTKER & LOKKEN, *supra* note 20, ¶ 100.3.4 nn.63 & 70; HOPKINS, *supra* note 20, at 185.
36. *E.g.*, Rev. Rul. 67–342, 1967–2 C.B. 187 (dissemination of information on the need for international cooperation); Rev. Rul. 67–4, 1967–1 C.B. 121 (information about specific types of physical and mental disorders).
37. Rev. Rul. 71–421, 1971–2 C.B. 229; *see* Ann Arbor Dog Training Club, Inc., v. Commissioner, 74 T.C. 207 (1980).

organizations—that is, organizations that espouse particular ideas or view-points. Finally, there is the issue of exemption for racially-segregated schools that nevertheless clearly meet the regulations' definition of an educational institution. These problems have led the IRS and courts to search, mostly unsuccessfully, for ancillary limitations on the regulatory concept of education.

a. The Commerciality Doctrine

Perhaps the most unsuccessful attempt at limiting the scope of the educational definition has been the "business activity" or "commerciality" doctrine. This doctrine arises from the regulations' interpretation of the exemption requirement that an organization pursue exclusively a charitable purpose. According to the regulations, an organization may be exempt under § 501(c)(3) even if it operates a trade or business, as long as such trade or business is either "insubstantial" or, if substantial, is "in furtherance of the organization's exempt purpose."[38] The IRS has invoked this "primary purpose" test to deny exemption to organizations that it believes operate largely like for-profit businesses. In the educational area, for example, the doctrine has been invoked in a number of "publication" cases in which the IRS claimed that the entity seeking exemption was nothing more than a commercial publisher.[39]

In *Scripture Press Foundation v. United States*,[40] for example, the Court of Claims held that an organization that published teaching materials for Bible classes operated primarily for profit and only secondarily as an educational (and religious) institution. Accordingly, it was not exempt, having violated the primary purpose test.[41] Similarly, in *The Incorporated Trustees of the Gospel Worker Society v. United States*,[42] the district court found that an exempt religious and educational organization engaged in dissemination of religious literature had evolved into the equivalent of a commercial press, generating an earned surplus of $5.3 million by 1978. Likewise, an organization that published two periodicals containing economic forecasts and securities analysis was held not exempt since its activities in essence amounted to investment advice to subscribers for a fee.[43]

Publishing, however, has not been the only educational activity bitten by the commerciality doctrine. In *Est of Hawaii v. Commissioner*,[44] the Tax Court held that an organization clearly engaged in educational activities such as seminars, lectures and training in personal awareness nevertheless was not exempt because it was "part of a franchise system which is operated for private benefit

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38. Treas. Reg. §§ 1.501(c)(3)–1(c), 1.501(c)(3)–1(e) (as amended in 1961).

39   *See* Rev. Rul. 67–4, 1967–1 C.B. 121 (publishing must be done in a manner "distinguishable from ordinary commercial publishing practices"); *see generally* Daniel Shaviro, *From Big Mama Rag to National Geographic: The Controversy Regarding Exemptions for Educational Publications*, 41 TAX L. REV. 693, 722–28 (1986); BITTKER & LOKKEN, *supra* note 20, ¶ 103.2, at 103–5 to 103–8; HOPKINS, *supra* note 20, at 188–93.

40.   285 F.2d 800 (Ct. Cl. 1961), *cert. denied*, 368 U.S. 985 (1962).

41.   *Id.* at 805–06.

42.   501 F. Supp. 374 (D.D.C.), *aff'd*, 672 F.2d 894 (D.C. Cir. 1981), *and cert. denied*, 456 U.S. 944 (1982); *see also* Fides Publishers Ass'n v. United States, 263 F. Supp. 924, 935 (N.D. Ind. 1967) (publication and sale of religious literature at a profit cannot be exempt because "every publishing house would be entitled to an exemption on the ground that it furthers the education of the public.").

43.   American Inst. for Economic Research v. United States, 302 F.2d 934 (Ct. Cl. 1962), *cert. denied*, 372 U.S. 976 (1963).

44.   71 T.C. 1067 (1979), *aff'd*, 647 F.2d 170 (9th Cir. 1981).

and its affiliation with this system taints it with a substantial commercial purpose."[45] Similarly, "investment clubs" formed to exchange investment information among members in order to promote their investment acumen are also not exempt even though they meet the broad definition of educational purposes.[46]

The major problem with the commerciality doctrine as applied by the IRS and the courts is that no clear guidance exists for when an activity crosses the line from exempt to "commercial." While courts tend to focus on whether the activity results in net receipts and is otherwise conducted in a "commercial manner,"[47] this focus is simply wrong-headed. Nothing in the statute or regulations requires charitable entities to operate at a loss or inefficiently to achieve exemption.[48] Moreover, the case-by-case analysis employed by the courts to date invites inexplicable variations in result. Thus activities that appear indistinguishable from one another are treated differently largely due to the "gut reaction" of the reviewing court concerning the motives of the founders of the organization. For example, in *Presbyterian & Reformed Publishing Co. v. Commissioner*,[49] the Third Circuit held exempt a religious publisher remarkably similar to that of *Scripture Press* noted above. The court stated in its opinion that "success in terms of audience reached and influence exerted, in and of itself, should not jeopardize the tax-exempt status" of the organization, and that large accumulations of cash should not be viewed suspiciously if reinvested in exempt activities.[50]

Another example of inconsistency lies in the fact that a number of activities in the educational area clearly are capable of being run as stand-alone businesses, such as university-associated bookstores or restaurants. If the focus of the commerciality doctrine is that goods and services provided by for-profit businesses are not appropriate subjects for tax-exemption, then any activity in an area populated by for-profit enterprise ought to lose exemption. This, however, clearly is not the existing law. Accordingly, the commerciality limitation, at least as applied by the IRS and courts to the current exemption standard, appears to lack any consistent theoretical base and hence is incapable of producing anything close to uniform results.[51]

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45. *Id.* at 1080.
46. Rev. Rul. 76–366, 1976–2 C.B. 144.
47. In Incorporated Trustees of the Gospel Worker Soc'y v. United States, 501 F. Supp. 374 (D.D.C. 1981), for example, the court stressed how the organization marketed its wares through commercial Christian bookstores with the same royalties and fees as commercial publishers. *See* Shaviro, *supra* note 39, at 723 (IRS emphasizes pricing policies; pricing significantly above cost of production indicates commercial activity); *see generally* BITTKER & LOKKEN, *supra* note 20, ¶ 103.2, at 103–06; HOPKINS, *supra* note 20, at 192–93.
48. As Bruce Hopkins notes, the pressures on charitable organizations to operate in a more "businesslike" manner, employing professional managers, creating reserves for equipment replacement and operations, and the like, has resulted in closer scrutiny by the IRS regarding exemption of activities previously thought virtually per se exempt. HOPKINS, *supra* note 20, at 191.
49. 743 F.2d 148 (3d Cir. 1984).
50. *Id.* at 158.
51. One could, of course, construct a theory that prohibits exemption for any entity that objectively operates as a commercial enterprise. In a sense, this is what the donative theory, *infra* text accompanying notes 185–211, does. *See also* James Bennett & Gabriel Rudney, *A Commerciality Test to Resolve the Commercial Nonprofit Issue*, 36 TAX NOTES 1095, 1097–98 (1987) (proposing taxing receipts of any sale of product or service unless (1) more than 50% of the cost of production is financed by gifts or grants as opposed to sales receipts or investment income, and (2) the subsidized product is "directed at a specific recipient group or purpose

b. Private Benefit/Inurement

A second theory used by the IRS to police the educational exemption (and the exemption area in general) is the private benefit/inurement doctrine. This doctrine arises from the statutory provision that no entity will be exempt unless "no part of [its] net earnings inures to the benefit of any private shareholder or individual ...."[52] The IRS actually breaks this doctrine into two parts: the private inurement limitation that is actually part of the statutory language, and a limitation on *private benefit* that is derived from the statutory language and separately stated in the regulations ("[an entity must not be] operated for the benefit of private interests such as designated individuals").[53]

The private inurement concept is easy to define and well-developed in the tax exemption case law. It simply refers to a situation in which the entity's economic benefits are diverted from the charitable class the entity is supposed to serve into the hands of "insiders" such as officers, directors, employees and the like.[54] Examples of prohibited private inurement include excessive salaries paid to a manager or controlling individual,[55] excessive rent paid by the exempt entity to an insider lessor,[56] inadequate rent charged by the entity to an insider,[57] below-market loans made by the exempt entity to an insider,[58] and so on. Since most private inurement situations are not subtle and involve a clear abuse of the economic benefits of exemption, this limitation is both appropriate and relatively straightforward.[59]

The related private benefit concept, however, is another story. One recent IRS pronouncement equates private benefit to the situation in which an entity's benefits appear to flow primarily to a narrow group, rather than to the general community.[60] The concept has been especially useful in the educational area, where the IRS invokes it to deny exemption to "captive" schools. For

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deemed charitable.").
  52. I.R.C. § 501(c)(3) (1993).
  53. Treas. Reg. § 1.501(c)(3)–1(d)(1)(ii) (as amended in 1961).
  54. BITTKER & LOKKEN, *supra* note 20, ¶ 100.4; HOPKINS, *supra* note 20, at 264–66; TREUSCH, *supra* note 20, at 241–47; *see also* John D. Colombo, *Are Associations of Doctors Tax-Exempt? Analyzing Inconsistencies in the Tax-Exemption of Health Care Providers*, 9 VA. TAX REV. 469, 482–85 (1990).
  55. *E.g.*, Birmingham Business College, Inc. v. Commissioner, 276 F.2d 476, 480–81 (5th Cir. 1960); Sonora Community Hosp. v. Commissioner, 46 T.C. 519, 526 (1966), *aff'd*, 397 F.2d 814 (9th Cir. 1968); *see* HOPKINS, *supra* note 20, at 276–78; TREUSCH, *supra* note 20, at 248–49.
  56. *E.g.*, Maynard Hosp. v. Commissioner, 52 T.C. 1006, 1031–32 (1969); *Sonora Community Hosp.*, 46 T.C. at 526; *see* HOPKINS, *supra* note 20, at 279; TREUSCH, *supra* note 20, at 250.
  57. *E.g.*, Harding Hosp. v. United States, 505 F.2d 1068, 1078 (6th Cir. 1974); *Maynard Hosp.*, 52 T.C. at 1031–32; *see* HOPKINS, *supra* note 20, at 279; TREUSCH, *supra* note 20, at 250.
  58. *E.g.*, John Marshall Law Sch. v. United States, 81-2 T.C. (CCH) ¶ 9514 (Ct. Cl. 1981); *see* HOPKINS, *supra* note 20, at 279–80; TREUSCH, *supra* note 20, at 251–52.
  59. Obviously, some definitional problems exist with this limitation, such as defining when compensation is excessive, when a loan is at a below-market interest rate, and others. These problems, however, are endemic to a tax system that permits deductions only for "reasonable" compensation and the like; these are not exemption-specific issues. Moreover, some external standards do exist in these areas: one can judge the appropriateness of an interest rate by reference to the prime rate or other bank rates; rent can be judged by reference to similar space on the open market and so on.
  60. Gen. Couns. Mem. 38,862, CCH IRS Positions ¶ 2327 (Nov. 21, 1991).

example, in *American Campaign Academy v. Commissioner*,[61] the Tax Court held that a school for training political campaign professionals was not exempt despite its clear educational purpose ("training the individual") because nearly all of the school's graduates were employed by the Republican Party. Similarly, an organization operated to protect the financial stability of a teachers' retirement system by disseminating information through a newsletter and engaging in litigation when necessary was held not exempt because it served primarily the private interests of its teacher-members.[62]

The private benefit limitation as applied to the educational exemption suffers the same problem as the commerciality doctrine: no obvious line exists for deciding when the benefits conferred by an organization otherwise clearly engaged in "training the individual" are "too private." For example, the IRS apparently has no problem with exempting organizations that conduct professional seminars or training, such as continuing legal education.[63] Clearly, the benefits of these organizations are limited to a fairly narrow group. Law students familiar with the "slippery slope game" will quickly recognize the trap of trying to distinguish between "proper" limited audiences and "improper" ones: is an organization that gives seminars only to IBM employees "too private"? How about to just IBM and Apple employees? IBM, Apple and Microsoft? All computer hardware employees? All employees of the "computer industry," however we define that phrase? Obviously, the private benefit limitation, whatever it may be, leaves entirely too much discretion to the IRS and courts to decide when an exemption is warranted and virtually no guidelines for exercising it.

c. Education vs. "Propaganda"

Since the early days of the educational exemption, the IRS has taken the position that certain "advocacy groups" do not qualify for exemption. The regulations state that an organization can qualify as educational even if it advocates a particular viewpoint, as long as it presents "a sufficiently full and fair exposition of the pertinent facts to permit an individual or the public to form an independent opinion or conclusion."[64] If, however, an organization's purpose is merely the "presentation of unsupported opinion," it will not qualify.[65] Nor will an organization qualify if its presentation of viewpoint crosses the line into an impermissible amount of legislative lobbying.[66]

The D.C. Circuit, however, held the "full and fair exposition" test unconstitutionally vague in *Big Mama Rag, Inc. v. United States*.[67] The taxpayer

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61. 92 T.C. 1053 (1989).
62. Retired Teachers Legal Defense Fund, Inc. v. Commissioner, 78 T.C. 280 (1982).
63. Kentucky Bar Found., Inc. v. Commissioner, 78 T.C. 921 (1982) (continuing legal education); Rev. Rul. 74–16, 1974–1 C.B. 126 (managing credit unions); Rev. Rul. 65–298, 1965–2 C.B. 163 (update seminars for physicians); Rev. Rul. 68–504, 1968–2 C.B. 211 (banking). *See* HOPKINS, *supra* note 20, at 183.
64. Treas. Reg. § 1.501(c)(3)–1(d)(3)(i) (1990).
65. *Id.*
66. Treas. Reg. § 1.501(c)(3)–1(c)(3) states that an "action" organization will not qualify for exemption. An "action" organization is one that attempts to influence legislation as a substantial part of its activities. *Id.* The statute itself permits an "insubstantial" amount of legislative lobbying and Code § 501(h) provides an elective mathematical expenditure test for exempt organizations to determine the appropriate amount of lobbying.
67. 631 F.2d 1030 (D.C. Cir. 1980); *see generally* BITTKER & LOKKEN, *supra* note 20,

in this case published a newspaper dedicated to feminist issues, and the IRS had denied an exemption because of the "political and legislative commentary" in the paper, as well as articles and editorials "promoting lesbianism."[68] The court noted that according to the Internal Revenue Manual, whether an organization was an "advocacy" organization subject to the "full and fair exposition" test was a question of whether its position was "controversial." As a result, the IRS had no objective standard by which to judge which organizations were subject to the test, and no standards by which to judge when the test was met.[69]

In response to *Big Mama Rag*, the IRS adopted a four-part "methodology test" that purports to decide educational status based upon the methodology used by the organization in promoting its viewpoint, rather than on the viewpoint itself. The four factors identified by the IRS in this test are (1) whether the presentation of viewpoints or positions unsupported by facts is a significant portion of the organization's communications; (2) whether the facts that purport to support the viewpoints or positions are distorted; (3) whether the organization's presentations make substantial use of inflammatory and disparaging terms, expressing conclusions based more on strong emotional feelings than on objective evaluations; and (4) whether or not the approach used in the organization's presentations is aimed at developing an understanding on the part of the intended audience or readership by considering their background or training in the subject matter.[70] Using this test, the IRS denied exemption to an organization that openly advocated race war, and the denial was upheld by the D.C. Circuit in *National Alliance v. United States*,[71] a decision rendered three years after *Big Mama Rag*. The court, however, refused to specifically approve the methodology test in its opinion, relying instead on a mostly unsupported conclusion that the publication in question could not fit the definition of "educational" as used in § 501(c)(3).[72]

Neither the "full and fair exposition" test nor the "methodology" test has fared well with commentators. As one might expect, all the written commentary to date agrees with the D.C. Circuit that the "full and fair exposition" test places too much discretion in the hands of the IRS without adequate objective guidelines for exercising it (a theme that should now be familiar).[73] Nor have commentators found the methodology test much of an improvement.[74] The reasoning behind these views is simple. The Treasury has never articulated any

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¶ 100.3.4; HOPKINS, *supra* note 20, at 195–96; TREUSCH, *supra* note 20, at 189–93.

68.   631 F.2d at 1033. The IRS also claimed that the organization was nothing more than a commercial newspaper publisher. *Id.* See *supra* text accompanying notes 38–51, for a discussion of the IRS's application of the commerciality doctrine.

69.   631 F.2d at 1036–39.

70.   Rev. Proc. 86–43, 1986–2 C.B. 729.

71.   710 F.2d 868 (D.C. Cir. 1983).

72.   In a distinctly "I know education when I see it and this is not it" vein, the court concluded "The material may express the emotions felt by a number of people, but it cannot reasonably be considered intellectual exposition." *Id.* at 873, 876.

73.   *E.g.*, Shaviro, *supra* note 39, at 736 (full and fair exposition text "ideologically biased"; should be replaced with neutral standards judging educational content); Thompson, *supra* note 27, at 487 (criticizing both the full and fair exposition and methodology test as unadministrable, leaving too much discretion in IRS and unnecessary; advocating exemption for all propaganda organizations unless they advocate illegal activities); Comment, *Tax Exemptions for Educational Institutions: Discretion and Discrimination*, 128 U. PA. L. REV. 849 (1980) (full and fair exposition test invites "unfair administration").

74.   *See* Shaviro, *supra* note 39, at 729 n.181; Thompson, *supra* note 27, at 511–32.

precise reason for the propaganda limitation. The history of the educational definition in the regulations, however, supports two potential concerns. The first is that propaganda organizations are not "charitable" because they advance the specific viewpoints of their founders—they are, in a sense, "selfish" rather than charitable.[75] Second, certain "propaganda" may be deemed harmful to the public.[76] Neither of these concerns, however, explains the scope of the propaganda limitation. Charitable institutions invariably reflect the views of their founders and even traditional educational institutions such as universities engage in a considerable amount of viewpoint-pushing.[77] More than a few educators, in fact, view the noblest purpose of universities as nurturing unpopular ideas that may, at least in the beginning, have little factual foundation. Having embraced the position that "educational institutions" extend beyond traditional schools, the IRS is very hard-pressed to distinguish between propaganda activities of schools and those of other organizations. As to the second potential concern, the legal and political tradition of the United States strongly encourages propagation of doctrine—"propaganda"—and debate over viewpoints as an inherent part of the democratic process. One should view very suspiciously any tax doctrine that in effect permits the IRS to be censor based upon viewpoint, a practice that apparently has occurred with respect to homosexual rights groups.[78] Accordingly, the propaganda limitation appears to suffer the same malady as the commerciality and private benefit doctrines: too much discretion and the lack of objective criteria for exercising that discretion stemming from a lack of clear theoretical underpinning for the limitation.

d. The Public Policy Limitation

Perhaps no aspect of tax exemption for educational institutions (or, for that matter, exemption in general) has received more commentary than the IRS's decision to withhold exemption from racially discriminatory schools,[79] a

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75. Thompson, *supra* note 27, at 511–12.
76. *Id.* at 519–24.
77. *Id.* at 514–16. Education scholars, in fact, have noted that one of the primary reasons for the existence of private schools is parental disenchantment with the values or educational methods used in public schools. *See* Donald A. Erikson, *Choice in Private Schools: Dynamics of Supply and Demand, in* PRIVATE EDUCATION: STUDIES IN CHOICE AND PUBLIC POLICY 82, 86–92 (Daniel C. Levy ed., 1986) (describing Catholic, Fundamentalist and Jewish private elementary schools); Mary–Michelle Upson Hirschoff, *Public Policy Toward Private Schools: A Focus on Parental Choice, in* PRIVATE EDUCATION: STUDIES IN CHOICE AND PUBLIC POLICY 33, 33–35 (Daniel C. Levy ed., 1986) (parental choice in education is a fundamental goal of mixed educational system). In a sense, therefore, traditional private schools have existed precisely because of parental desires to indoctrinate their children with specific viewpoints.
78. *See* Thompson, *supra* note 27, at 524–32. One Treasury Department's General Counsel's Memorandum actually went so far as to state that the IRS had a "legitimate" concern that the activities of certain organizations advocating homosexual rights could harm society by encouraging or facilitating homosexual practices. Gen. Couns. Mem. 37,173 (June 21, 1977).
79. *E.g.,* Ricki J. Schweizer, Comment, *Federal Taxation—Exempt Organizations—Constitutional Law—First Amendment—Right to Free Exercise of Religion*—Bob Jones University v. United States, 30 N.Y.L. SCH. L. REV. 825 (1985); William A. Drennan, Note, Bob Jones University v. United States: *For Whom Will the Bell Toll?*, 29 ST. LOUIS U. L.J. 561 (1985); Karla W. Simon, *Applying the* Bob Jones *Public-Policy Test in Light of TWR and U.S. Jaycees,* 62 J. TAX'N 166 (1985); Miriam Galston, *Public Policy Constraints on Charitable Organizations,* 3 VA. TAX REV. 291 (1984); Sherri L. Thornton, Case Note, *Taxation in Black and White: The Disallowance of Tax-Exempt Status to Discriminatory Private Schools*—Bob Jones University v. United States, 27 HOW. L.J. 1769 (1984); Joe W. Miller, Note, *Applying a Public Benefit Requirement to Tax-Exempt Organizations,* 49 MO. L. REV.

decision upheld by the United States Supreme Court in *Bob Jones University v. United States*.[80] The Court observed that entitlement to tax exemption depended on meeting certain common law standards of charity, including a requirement that the organization's purpose not be illegal or contrary to established public policy.[81] Finding a strong public policy against racial discrimination in education, the Court upheld the IRS's denial of exemption in the case. The Court, however, recognized the potential breadth of the "public policy" limitation, and accordingly cautioned in its opinion that exemption should be denied "only where there can be no doubt that the activity involved is contrary to a fundamental public policy."[82]

Commentary on the public policy exemption has been mixed. The dissenting justice viewed the Court's decision as unwarranted judicial legislation, a view supported by some commentators.[83] Others have complained that the court decision unnecessarily infringes on the free exercise of religion, an issue that the Court majority answered in the negative.[84]

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353 (1984); Daniel L. Johnson, Jr., Note, *Federal Taxation*—Bob Jones University v. United States: *Segregated Sectarian Education and IRC Section 501(c)(3)*, 62 N.C. L. REV. 1038 (1984); William Chamblee, Case Note, *IRS Acted Within Its Authority in Determining that Racially Discriminatory Non-Profit Private Schools Are Not "Charitable" Institutions Entitled to Tax-Exempt Status*, 15 ST. MARY'S L.J. 461 (1984); Rufus Kee, Case Note, *The I.R.S. Fights Racial Discrimination in Higher Education: No Tax Exemption for Religious Institutions That Discriminate Because of Race.* "Bob Jones University," 10 S.U. L. REV. 291 (1984); Charles O. Galvin & Neal Devins, *A Tax Policy Analysis of* Bob Jones University v. United States, 36 VAND. L. REV. 1353 (1983); David Asaki et al., Comment, *Racial Segregation and the Tax-Exempt Status of Private Educational and Religious Institutions*, 25 HOW. L.J. 545 (1982); Douglas Laycock, Observation, *Tax Exemptions for Racially Discriminatory Religious Schools*, 60 TEX. L. REV. 259 (1982); Paul S. Milich, *Racially Discriminatory Schools and the IRS*, 33 TAX LAW. 571 (1980); Comment, *Tax Exemptions for Educational Institutions: Discretion and Discrimination*, 128 U. PA. L. REV. 849 (1980); David L. Anderson, *Tax Exempt Private Schools Which Discriminate on the Basis of Race: A Proposed Revenue Procedure*, 55 NOTRE DAME LAW. 356 (1980); Robert J. Christians, Note, *The IRS, Discrimination, and Religious Schools: Does the Revised Proposed Revenue Procedure Exact Too High a Price?*, 56 NOTRE DAME LAW. 141 (1980); Thomas Stephen Neuberger & Thomas C. Crumplar, *Tax Exempt Religious Schools Under Attack: Conflicting Goals of Religious Freedom and Racial Integration*, 48 FORDHAM L. REV. 229 (1979); Note, *The Judicial Role in Attacking Racial Discrimination in Tax-Exempt Private Schools*, 93 HARV. L. REV. 378 (1979); Colleen K. Connell, Comment, *The Tax-Exempt Status of Sectarian Educational Institutions that Discriminate on the Basis of Race*, 65 IOWA L. REV. 258 (1979); Wilfred F. Drake, *Tax Status of Private Segregated Schools: The New Revenue Procedure*, 20 WM. & MARY L. REV. 463 (1979); Bruce N. Bagni, *Discrimination in the Name of the Lord: A Critical Evaluation of Discrimination by Religious Organizations*, 79 COLUM. L. REV. 1514 (1979); Richard S. Myers, Note, *The Internal Revenue Service's Treatment of Religiously Motivated Racial Discrimination by Tax Exempt Organizations*, 54 NOTRE DAME LAW. 925 (1979); Jerome Kurtz, *Difficult Definitional Problems in Tax Administration: Religion and Race*, 23 CATH. LAW. 301 (1978). If my math is correct, this list counts twenty-three separate articles, or approximately four times the number of articles examining the scope of tax exemption in general.

    80.   461 U.S. 574 (1983).

    81.   *Id.* at 591–92.

    82.   *Id.* at 592.

    83.   *Id.* at 612–23 (Rehnquist, J., dissenting); *see* Drennan, *supra* note 79, at 596; Galvin & Devins, *supra* note 79, at 1379; Johnson, *supra* note 79, at 1038 (1984); Myers, *supra* note 79, at 950; Schweizer, *supra* note 79, at 855.

    84.   The Court responded to Bob Jones University's contention that denial of exemption interfered with its right to free exercise of religion by noting that the government's interest in nondiscrimination was "compelling," "fundamental" and "overriding," and hence "substantially outweighs" any burden that the denial of exemption placed on free exercise. *Bob Jones Univ.*, 461 U.S. at 604. Moreover, the Court observed that denial of exemption did not prohibit Bob

By far the most common complaint, however, is that the "fundamental public policy" standard is "open-ended and beclouded,"[85] leaving far too much discretion in the hands of the IRS.[86] Because the requirement appears to have been taken from the common law of charitable trusts, it has no theoretical grounding in the tax laws and no development other than in a body of law primarily concerned with whether a donor can place money in trust for a specific cause in perpetuity.[87] As a concurring Justice worried, if not adequately restrained, the Court's decision could reach organizations with unpopular ideas that contribute to diversity of viewpoint essential to a pluralistic society; in any event, the IRS should not be making such substantive decisions.[88] In fact, evidence exists that the IRS already exercises extremely broad discretion in this area,[89] and that lower courts have not yet fully defined how strong or definitely-stated a public policy must be in order to affect exempt status. Most courts, for example, have held in non-educational cases that gender discrimination does not adversely affect exemption.[90] Thus the public policy constraint appears to suffer from the same lack of theoretical grounding and definitional consistency observed for the other limiting principles.

B. State Exemption Standards

While generalizations about state exemption standards are somewhat hazardous, state tax exemption tends to follow the federal pattern. State income tax exemption statutes generally either automatically confer exemption on any organization exempt under federal income tax law, thus incorporating federal

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Jones University from exercising its religious beliefs: it would simply have to do so without exempt status. *Id.* For a contrary view, see Joseph H. Helm, Jr., Note, *Denying Tax Exemption to Racially Restrictive Religious Schools: An Unconstitutional Infringement Upon Religious Membership Practices,* 17 VAL. U. L. REV. 437 (1983).

85. Galvin & Devins, *supra* note 79, at 1373, 1379; Schweizer, *supra* note 79, at 856.

86. *See* Anderson, *supra* note 79, at 378; Drennan, *supra* note 79, at 596; Galvin & Devins, *supra* note 79, at 1373; Neuberger & Crumplar, *supra* note 79, at 275; *see also* Galston, *supra* note 79 (criticizing use of trust law definitions).

87. As I previously have noted, charitable trust law is designed primarily to define when assets can be left in trust in perpetuity and when the law will relax certain technical requirements of trusts, such as a definite class of beneficiaries. Hall & Colombo II, *supra* note 14, at 334–44. Because of the relatively low enforcement costs involved, charitable trust law always has veered toward an expansive definition of charity. In fact, charitable trust law has very little in the way of *substantive* limitation on its subject matter (most charitable trust restrictions are concerned with procedural issues, such as sufficiently broad beneficiaries and the like). *Id.* When the only issue in question is whether a particular individual can leave her own money in perpetuity to promote some cause the donor found important, an expansive definition of charity probably is warranted, or at least defensible. When the issue is whether government should spend everyone's tax dollars (by giving up revenue that otherwise would be available from exempt entities) for that particular cause, as it is with exemption, every reason exists to be careful, if not stingy, in applying the charitable label.

88. *Bob Jones Univ.,* 461 U.S. at 606–11 (Powell, J., concurring); *see* Michael F. Merra, Comment, Bob Jones University v. United States: *The Emergence of IRS Quasi-Legislative Authority,* 19 NEW ENG. L. REV. 917 (1984); Charles O. Galvin & Neal Devins, *A Tax Policy Analysis of* Bob Jones University v. United States, 36 VAND. L. REV. 1353, 1373 (1983).

89. For example, the IRS uses a public policy analysis in determining whether demonstrations, economic boycotts, strikes and picketing are permissible activities by charitable organizations. *See* Gen. Couns. Mem. 37,858 (Feb. 16, 1979); *see generally* HOPKINS, *supra* note 20, at 84.

90. *E.g.,* New York City Jaycees, Inc. v. United States Jaycees, Inc., 512 F.2d 856 (2d Cir. 1975); Junior Chamber of Commerce, Inc., v. United States Jaycees, 495 F.2d 883 (10th Cir. 1974); McCoy v. Shultz, 73-1 T.C. (CCH) ¶ 9233 (D.D.C. 1973).

exemption standards directly,[91] or else use exemption language that mirrors the IRC definition, in which case federal standards likely would be used by analogy.[92]

Property tax exemptions, on the other hand, usually do not directly key off federal exemption, but rather are covered by independent state statutes or constitutional provisions.[93] The predominant pattern of these statutes confers exemption on religious, educational and charitable organizations;[94] hence as is the case with federal law, states must contend with the definition of "educational" in interpreting state property tax exemption. Most states, however, appear to follow the federal scheme of broadly interpreting education to include not only traditional schools but a variety of arts, cultural preservation and other organizations.[95]

States also appear to follow the federal lead in the limiting doctrines used to circumscribe the exemption. Organizations that operate in a commercial manner or generate excess revenues likely will be denied exemption.[96] The "public purpose" requirement of most states mirrors the private inurement/benefit requirement of federal tax law,[97] and states find rationales to

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91. At last count, some twenty-two states followed this approach. For a list, see Hall & Colombo II, *supra* note 14, at 323–24 n.53. *See also* W. HARRISON WELLFORD & JANNE G. GALLAGHER, UNFAIR COMPETITION? THE CHALLENGE TO CHARITABLE TAX EXEMPTION 153–260 (1988) (fifty-state survey of charitable exemption laws).

92. Another ten states use this approach. Hall & Colombo II, *supra* note 14, at 323–24 n.53.

93. Ginsberg, *supra* note 7, at 292 (every state has a property tax exemption statute and all but seven have a constitutional provision on the subject).

94. *See* Hall & Colombo II, *supra* note 14, at 324 n.55.

95. PETER L. SWORDS, CHARITABLE PROPERTY TAX EXEMPTIONS IN NEW YORK STATE 170–74 (1981) (although one case appears to restrict educational exemption to formal schools, in fact many New York cases have interpreted the exemption broadly, covering items as diverse as a 500-acre nature preserve and art gallery); Ginsberg, *supra* note 7, at 330 (museums and nature preserves generally have been exempted by states as educational institutions); Arnold W. Reitze, Jr., *Real Property Tax Exemptions in Ohio—Fiscal Absurdity,* 18 CASE W. RES. L. REV. 64, 74–75 (criticizing breadth of educational exemption in Ohio). Even in those states that profess to follow more restrictive interpretations of "educational" (such as by restricting the exemption to traditional schools), museums, performing arts entities, cultural organizations and a variety of other institutions generally are exempted under the general charitable label. *E.g.,* Kalamazoo Aviation History Museum v. City of Kalamazoo, 346 N.W.2d 862 (Mich. Ct. App. 1984) (museum not exempt as an educational organization because it does not teach students but is exempt as a charitable organization); Warren, Jr. et al., *supra* note 10, at 230–39 (education exemption in Connecticut may require systematic instruction; other institutions, however, are exempt under general "charitable" label: a summer camp, for example).

96. *E.g.,* Presbyterian Residence Ctr. Corp. v. Wagner, 397 N.Y.S.2d 765, 766–67 (N.Y. App. 1978) (denying exemption for apartment complex for the elderly, finding complex was "indistinguishable from a commercial apartment complex having appurtenant recreational facilities"); Leland Standford Junior Univ. v. County of Santa Clara, 86 Cal. App. 3d 79, 84 (1978) (property not exempt if used primarily as a revenue generating device); Ginsberg, *supra* note 7, at 316–19 (noting that the nonprofit requirement of exempt status might be violated by consistent production of revenue in excess of expenses and that many states frown on charging full cost of services provided by charitable institutions); Warren, Jr. et al., *supra* note 10, at 242–43 (noting that Connecticut "exclusive use" requirement does not permit exemption for property used for commercial purposes).

97. *E.g.,* Alcoser v. County of San Diego, 111 Cal. App. 3d 907 (1980) (vocational school operated by construction union primarily for union members and employers not exempt); SWORDS, *supra* note 95, at 155–61 (discussing public benefit requirement and New York prohibition on "pecuniary profit" flowing to any private individual); Ginsberg, *supra* note 7, at 312–22 (noting public versus private benefit distinction in state laws); Warren, Jr. et al., *supra* note 10, at 244 ("no private profit" provision of Connecticut law).

withhold exemption from propaganda institutions.[98] The public policy doctrine, moreover, originated with the state common law of charitable trusts.[99]

C. Summary

Both the federal and most state tax definitions of education for exemption purposes are extremely broad, grounded in common-law definitions of charity taken from charitable trust law that have little in common with tax administration. At the federal level, this breadth has required the IRS to turn to various other doctrines to limit the scope of the exemption, and states appear to follow this federal lead. With the exception of the private inurement (as opposed to private benefit) doctrine, however, all these limiting doctrines suffer to a greater or lesser degree from their own lack of definition, leaving the IRS and its state counterparts with virtually unlimited discretion in their application and little in the way of guidance for applying that discretion. One is tempted to call the situation a mess.

IV. THEORIES OF EXEMPTION AND PRIVATE EDUCATIONAL INSTITUTIONS

As the discussion in Part III indicated, the current standards for exemption of educational institutions fail to include any consistent limiting principle. This failure largely results from the historic lack of any legislative consideration of the underlying reasons for exemption. The state exemption grew from the medieval notion that one could not tax God, while the federal exemption appears simply to have adopted widespread state practice without any particular thought regarding its theoretical fit in an income tax system. In this section I search for such a limiting principle by applying to the educational exemption the various theories that have been advanced to explain charitable tax exemptions.

A. The Nature of Exemption: Bittker's Income Measurement Theory

While several theories of exemption exist, these theories break into two general groups: tax-base theories and subsidy theories. In general, the subsidy theories view the tax exemption as an implicit subsidy to the exempt organization equal to the amount of taxes foregone as a result of exemption.[100] The tax-base theories, on the other hand, justify exemption as a natural outgrowth of the inability to accurately measure the income of nonprofit organizations or to assess the incidence of tax that would occur if exemption were not available.[101]

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98. *E.g.*, Swedenborg Found., Inc. v. Lewisohn, 351 N.E.2d 702 (N.Y. 1976) (organization formed to disseminate writings of Swedish philosopher not exempt); SWORDS, *supra* note 95, at 168–70 ("activities designed to influence opinion" is "a type of action which has been sharply set off from educational under many exemption statutes.").

99. *See* Bob Jones Univ. v. United States, 461 U.S. 574, 586, 591–92 (1983) (entitlement to tax exemption dependent on meeting common-law standards of charity; common law of charitable trusts does not permit a trust that is illegal or violates established public policy).

100. *See* Simon, *supra* note 5, at 69, 73–82; Atkinson, *supra* note 6, at 605–10; Hansmann II, *supra* note 6, at 66; Hall & Colombo II, *supra* note 14, at 313; *Developments in the Law: Nonprofit Corporations*, 105 HARV. L. REV. 1578, 1620 (1992); Note, *Alternatives to the University Property Tax Exemption*, 83 YALE L.J. 181, 183 (1973).

101. Simon, *supra* note 5, at 73–75; Bittker & Rahdert, *supra* note 6, at 304; Atkinson, *supra* note 6, at 610–13; Hansmann II, *supra* note 6, at 58–59; Hall & Colombo II, *supra* note 14, at 313 n.12.

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Whether one views exemption as the equivalent of a government subsidy or simply as a natural outgrowth of a taxing system aimed at measuring income (or property value) impacts one's view of the proper scope of exemption: if the tax-base theories are correct, for example, then questions regarding whether society might be better off taxing that entity and applying the revenues elsewhere simply do not arise, because those entities cannot be brought into the taxing system in the first place.

The most thorough exposition of the tax-base theory is contained in Boris Bittker and George Rahdert's landmark 1976 article on the nature of tax exemption.[102] In this article, the authors argue that nonprofits are exempt from federal income tax because of the inherent difficulty in measuring their income and assessing the incidence of tax.[103] For example, donations to charitable entities would not appear to be income, but rather gifts exempt from income taxation under § 102 of the Code.[104] Expenditures by these entities on their beneficiaries might not be classified as deductible business expenses, because an entity that does not seek profit generally is not considered engaged in a "trade or business" for purposes of Code § 162, governing business expense deductions.[105] Moreover, selecting an appropriate tax rate for charitable entities is difficult. If one conceives of a charitable organization as a kind of trust doling out assistance to its beneficiaries on a need basis, the proper tax rate would be the rate applicable to the beneficiaries. The breadth of most charitable classes, however, makes such "imputation" rates incalculable, simply because all the beneficiaries are unknown.[106] Substituting an entity tax for a beneficiary tax would be possible, but would run the risk of overtaxing because most beneficiaries of charitable institutions likely would be taxed at very low rates, if at all.[107] According to the authors, both these problems (lack of mechanisms for measuring income and expense and difficulty with an appropriate rate structure) apply to educational institutions.[108]

While it is undoubtedly true that many charitable institutions have no *net* income in the accounting sense,[109] Bittker and Rahdert's theory has serious problems both as an explanation of exemption in general and as an explanation of the educational exemption in particular. First, their theory lacks universality because it fails to explain the state property tax exemption. While it may be difficult to measure income for some charitable institutions, they most certainly own property, and their property is no more difficult to value than property owned by Microsoft or the corner grocery store.[110] In order for the "no

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102.   Bittker & Rahdert, *supra* note 6.

103.   *Id.* at 305. One should note that Bittker and Rahdert's article does not limit its discussion to charitable organizations. Rather, it considers all types of tax exemption, including exemption for "mutual benefit" organizations such as fraternities, chambers of commerce and the like exempt under other subsections of I.R.C. § 501(c)(3) (1988).

104.   *Id.* at 308.

105.   *Id.* at 310.

106.   *Id.* at 314–15.

107.   *Id.*

108.   *Id.* at 333–35.

109.   That is, no surplus of revenues over expenses. *See* Simon, *supra* note 5, at 81 (income tax exemption provides little in the way of support for most nonprofits because they have no net revenues subject to tax).

110.   Some states, in fact, actually list exempt property on the tax rolls along with a valuation. *See* Simon, *supra* note 5, at 81; JoAnn Moody, *Tax Policy: Some Issues for Higher Education, in* FINANCING HIGHER EDUCATION: THE PUBLIC INVESTMENT 125, 129 (John C.

income" theory to be broadened to serve as an explanation for state property tax exemption, it would have to become a "no property" theory, which would be absurd. Whatever the rationale was for the original exemptions from property tax, it cannot have been that charitable entities lacked property to tax.[111]

Perhaps the biggest problem with the theory, however, is that it simply is wrong with respect to a number of exempt organizations. As Henry Hansmann has observed, many "charitable" organizations in fact derive all or nearly all their income from sales of goods or services they produce, and measuring income for such "commercial" nonprofits is no more difficult than for any other business.[112] Hospitals are one notable example, deriving virtually all their income from service fees.[113] Another commentator has noted that more charities are operating in a "businesslike" fashion, generating surplus receipts, hiring professional managers, creating reserves for operations and so on.[114] Thus whatever historic problems regarding income measurement may have existed are rapidly disappearing today. As for the rate-setting difficulties, our taxing system does not generally look toward an entity's customers in determining the tax rate for business enterprises.[115] In fact, the issue regarding the incidence of entity-level taxation (e.g., whether the tax ultimately is paid by the entity's customers, employees, or someone else) is one that economists have debated for decades.[116] The exemption, moreover, ignores completely the ability-to-pay of the entity's beneficiaries: in many instances (symphony orchestras, art museums, and Harvard all come to mind), the majority of patrons of the exempt entity have more than enough ability to pay.

Hoy & Melvin Bernstein eds., 1982) (listing exempt property valuations done by the Massachusetts Department of Revenue). Simon does note that state and local officials have every incentive to overvalue exempt property in making such estimates; hence the listed valuations probably are unreliable. Simon, *supra* note 5, at 81.

111. Other commentators, however, have used the "incidence of tax" prong of Bittker and Rahdert's argument to construct a tax-base theory of state property tax exemption. *E.g.*, SWORDS, *supra* note 95, at 191. According to Swords, the incidence of property tax must fall either on the exempt entity's beneficiaries or donors (he apparently does not consider the possibility that the tax results in reduced wages for employees). *Id.* at 206–09. Swords notes that many beneficiaries of charitable enterprises will be poor, and thus should not be subject to the incidence of property tax under the "ability to pay" criterion of assessing tax, just as Bittker and Rahdert argue that they should not be subject to the incidence of income tax. *Id.* at 207. Swords does acknowledge, however (as do Bittker and Rahdert) that often beneficiaries of exempt entities *are* people with the "ability to pay," but nevertheless justifies exemption as a method to keep prices of exempt goods or services low, which encourages wider distribution. The donative theory also posits that an exemption permits increased production of public goods that are systematically underproduced. *Infra* text accompanying notes 186–211. The donative theory, however, relies on donations as a proxy for underproduction; Swords appears to rely on intuition.

As for the contributors as a source of the tax, Swords argues that if the incidence of property tax falls on them, they in effect suffer a "double tax" since they have already paid their own property taxes, and the result might be fewer contributions. In fact, this may be an argument for exempting nonprofits that have a certain level of donations, which is exactly what the donative theory attempts to accomplish. *See infra* text accompanying notes 186–211.

112. Hansmann II, *supra* note 6, at 59.
113. *See* Hall & Colombo II, *supra* note 14, at 405–08.
114. HOPKINS, *supra* note 20, at 191.
115. Hansmann II, *supra* note 6, at 65; Simon, *supra* note 5, at 75 (noting that the incidence of taxation argument rests on the notion that the charitable entity is a conduit for its beneficiaries, a theory that has not been accepted in most of tax law).
116. Hansmann II, *supra* note 6, at 65 n.41.

More importantly for purposes of this Article, many private schools and other educational institutions fall into the "businesslike" category, deriving the great majority of their receipts from tuition and sales.[117] Whatever the difficulties of measuring income under the I.R.C. § 61 definition may be for other entities, tuition (fees for educational services rendered) and sales revenues fall squarely within the definition of § 61.[118] In addition, aside from the profit motive issue, the expenses of most educational institutions (teacher salaries, maintenance and the like) are classic examples of deductible business expenses under I.R.C. § 162.[119] One has the sneaking suspicion that Harvard, for example, could come up with a taxable income number if pressed to do so.[120] Finally, even Bittker and Rahdert concede that most private school students come from high income classes that otherwise would be subject to income tax, thus making the rate-setting problem less of a concern.[121] The same observation, of course, applies doubly to professional seminar organizations, whose beneficiaries (doctors, lawyers, bankers, etc.) hardly rank as poor. The result of this analysis is that if the "no income" theory were applied as a rigorous limiting principle for exemption, virtually no educational institutions would qualify.

The "no income" theory, therefore, ultimately is an unsatisfying explanation for both the exemption of charitable entities in general and the exemption of educational institutions in particular. These observations, of course, do not mean that either the colonial legislatures that enacted property tax exemptions for charitable institutions or Congress in 1894 explicitly viewed the exemption as the equivalent of a subsidy. In fact, as Bittker and Rahdert and many others have noted, both the federal income and state property tax exemptions stemmed from a more general, vague notion that such entities simply should not be taxed.[122] Not being aware of a specific rationale for exemption at the time of enactment, however, does not render inappropriate the view that exemption in fact is equivalent to the government forgiving the tax that otherwise would be due from the exempt entity. It is one thing to note that an entity has property or income potentially subject to tax and then consciously choose not to impose the tax. In this case, surely the choice not to impose tax is a form of benefit conferred by the government on the exempt entity. In fact, most local communities that play host to universities are today acutely aware of the economic benefit conferred by property tax exemption,[123] and all exempt entities are

117. Latest statistics, for example, show that private universities as a group derive about two-thirds of their revenues from such sources. CURRENT FUND REVENUES, *supra* note 1, at 12, tbl. 5.

118. *See* I.R.C. § 61(a)(1) (1988) (gross income includes "compensation for services, including fees ....").

119. *See* I.R.C. § 162(a)(1) (1988) (reasonable allowance for salaries).

120. *See* Rob Atkinson, *Rationales for Federal Income Tax Exemption 27, in* RATIONALES FOR FEDERAL INCOME TAX EXEMPTION (1991) (collection of papers prepared for the 1991 NYU Conference on Philanthropy and the Law) ("Tiffany's net income available for distribution to its stockholders is arguably different from the Red Cross's distributions of donations to flood victims, but the two could be made subject to tax with roughly equal convenience.").

121. Bittker & Rahdert, *supra* note 6, at 334.

122. Bittker & Rahdert, *supra* note 6, at 304; Simon, *supra* note 5, at 75; Diamond, *supra* note 10, at 4, 7–16 (exemptions "run endlessly in our past," resulting largely from historical practice rather than cost/benefit calculations).

123. This is why many such communities have begun asking for voluntary payments to reimburse the community for lost tax revenues. The City of Urbana, for example, recently

aware of it.[124] It is quite another thing to argue, as do Bittker and Rahdert, that the exemption exists because of an inherent inability to bring these entities into the tax base. As discussed above, this is clearly not true with respect to the property tax for any exempt entity, and not true with respect to the income tax for a number of entities, including the vast majority of educational institutions. Accordingly, most commentators, including this one, and virtually all court decisions conclude that exemption should properly be viewed as the equivalent of a government subsidy (or benefit).[125]

B. The Subsidy Theories

Once one eliminates as a reason for exemption the impossibility of bringing exempt entities into the tax base, then the question regarding exemption simply becomes one of normative standards to justify the benefit conferred by exemption. Under this view, which I broadly characterize as the subsidy view, certain evaluative criteria become obvious.[126] The first is that such a benefit should be conferred on an entity only when it is *deserved*. This criterion breaks into two subcomponents: *worth* and *need*. The worth component requires an entity to prove that the function it performs is one that society should support. Proving worth alone, however, is insufficient. The entity must also show need for the benefit. An entity might well continue its worthy function without government intervention. This is most obvious in the case of functioning private markets. We may view the software produced by Microsoft

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complained about the exempt status of the University of Illinois' married student housing, ostensibly because Urbana was incurring costs of educating such students' children, but the University was not contributing to such costs through property taxes. CHAMPAIGN–URBANA NEWS–GAZETTE, Mar. 25, 1993, at A1; CHAMPAIGN–URBANA NEWS–GAZETTE, Mar. 26, 1993, at A2. The city of Evanston, Illinois, voiced similar complaints about Northwestern University. *Evanston Sizes up Tax on Tuition for NU, Other Schools,* CHICAGO TRIBUNE, May 23, 1990, at 1. *See also* Note, *Alternatives to the University Property Tax Exemption,* 83 YALE L.J. 181, 185 (1973) (other universities already make "payments in lieu of taxes" to their host communities).

124.   Otherwise, there would be little in the way of hue and cry when exemption was revoked. J. David Seay, for example, has eloquently defended the tax exempt status of nonprofit hospitals by arguing that nonprofit hospitals promote community service and are (or to be exempt, should be) more responsive to community needs. J. David Seay, *Tax Exemption for Hospitals: Towards an Understanding of Community Benefit,* 2 HEALTH MATRIX 35, 45–48 (1992). Implicit in this defense, however, is a recognition that without the economic benefits of exemption, many nonprofit hospitals would cease to exist. If this were not the case, exempt status would be irrelevant, because the lack of exemption certainly would not prohibit hospitals from pursuing the lofty goals articulated by Seay. Put another way, Seay must view exemption as providing a necessary economic benefit that permits nonprofit hospitals to pursue their community service.

125.   *E.g.,* Regan v. Taxation Without Representation, 461 U.S. 540, 544 (1983) ("Both tax exemptions and tax deductibility are a form of subsidy that is administered through the tax system."); 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 ... which supplements and advances the work of public institutions already supported by tax revenues."); Hansmann II, *supra* note 6, at 66 ("A rather common view of the exemption is that it is a means of subsidizing particular services ...."); Atkinson, *supra* note 6, at 12 & n.18 (subsidy view is "widely expressed"; citing several authorities); Simon, *supra* note 5, at 75 (noting "limited popularity" of tax-base approaches); Charles T. Clofelter, *Federal Tax Policy and Charitable Giving, in* PHILANTHROPIC GIVING 105 (Richard Magat ed., 1989) ("The United States is distinctive in the degree to which it subsidizes the nonprofit sector through its tax system.").

126.   *See* Hall & Colombo II, *supra* note 14, at 328–31; Atkinson, *supra* note 6 (discussing issues of worthiness and "fit" throughout the analysis of various theories of exemption).

as a worthy social benefit, but because the private market supports Microsoft's continued production of software, no government intervention is necessary to ensure this continued production. A functioning private market, however, is not the only aspect of need. Even if the private market does not function with respect to a particular good or service, the need component is not necessarily satisfied; instead, need also requires showing that the undersupplied good or service cannot (or would not) be replaced as efficiently by the government providing such goods or services directly.

The second major evaluative criterion is *proportionality*. Once an entity demonstrates that a benefit is deserved, the amount of the benefit should relate in some way to the level of production of the worthy good or service. In a sense, proportionality overlaps need: there is no reason to give an entity a larger benefit than is necessary to ensure optimum production of the worthy good or service. In this criteria list, however, I view "need" as the threshold showing that a benefit is necessary to avoid irreparable diminution in the worthy good or service, and "proportionality" as the answer to the question "how much benefit is necessary?"

In addition to these two major criteria, two lesser, but still important considerations exist. These I have referred to in prior articles as *universality*, which is the hope that a particular theory of exemption can serve to explain both the income and property tax, and *historical consistency*, which refers to whether the theory adequately accounts for the general historical scope of exemption.

1. The Quid-Pro-Quo Theory

Perhaps the oldest justification for exemption of charitable institutions is that the exemption is a rough "quid-pro-quo" to charities for the cost of per-forming services that otherwise would have to be borne by the government.[127] This theory posits that the benefit of exemption is deserved because in the absence of the exemption, government would be required to pay the cost of the service or product provided by the exempt entity. While this theory establishes that exemption is deserved (as the quid-pro-quo for providing the desired services), the theory suffers from at least three serious deficiencies when applied to the educational area.

First is the question of need. If the justification for exemption is that the economic benefits conferred are a rough quid-pro-quo for the costs that would

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127. *See* H.R. Rep. No. 1860, 75th Cong. 3d Sess. 19 (1938) ("The exemption from taxation of money or property devoted to charitable and other purposes is based upon the theory the Government is compensated for the loss of revenue by its relief from the financial burden which would otherwise have to be met by appropriations from other public funds ...."); Bob Jones Univ. v. United States, 461 U.S. 574, 590 (1983) (quoting H.R. Rep. No. 1860 for rationale of exemption); McGlotten v. Connally, 338 F. Supp. 448, 456 (D.D.C. 1972) ("The rationale for allowing the deduction of charitable contributions has historically been that by doing so, the Government relieves itself of the burden of meeting public needs which in the absence of charitable activity would fall on the shoulders of Government."); Atkinson, *supra* note 6, at 12 n.18 (relief from government burden theory "widely expressed"); HOPKINS, *supra* note 20, at 8–9 (exemption is "derivative of the concept that they perform functions which, in the organizations' absence, government would have to perform); *Report of the Filer Commission, in* RESEARCH PAPERS SPONSORED BY THE COMMISSION ON PRIVATE PHILANTHROPY AND PUBLIC NEEDS 103 (U.S. Dep't of the Treasury ed., 1977) (relief of government burden theory "a frequently cited justification" for exemption).

otherwise be borne by the government in providing the exempt service, then exemption should be available to all providers of that service, whether or not they operate for profit.[128] For-profit educational institutions certainly exist. Recent data indicate that for-profit firms dominate vocational training, for example, constituting over 75% of both the number of schools and the revenues.[129] For-profit institutions also populate higher education and, albeit to a much lesser degree, primary education.[130] If nonprofit institutions relieve the government of the burden of educating their students, the same holds true for for-profit institutions, and hence the latter ought to qualify for exemption under this theory. Nevertheless, the obvious problem here is that for-profit institutions clearly cannot demonstrate a need for government assistance, since the private market appears to be working in this area. Thus the quid-pro-quo theory fails to adequately delimit the need factor of the deservedness criterion.[131]

Second, the theory has serious proportionality problems. To begin with, it is difficult to trace the burden being relieved by private schools to the governmental units granting exemption. As noted above, tax exemption for charitable institutions is a unified system: the "educational" label invokes not only federal income tax exemption, but also state income, sales and local property tax exemptions. Thus even if one finds indisputable the proposition that government in general should provide all levels of education to its populace, tax exemption is a peculiar way to allocate the costs involved. This is best illustrated by the local property tax exemption for private research universities, such as Harvard. Surely the city of Cambridge or the state of Massachusetts would not find it necessary to supply college and post-graduate education at their expense to the out-of-state (or out-of-city) students who attend Harvard. As another commentator has observed, "The city of Cambridge clearly is not giving the [local property tax] exemption [to Harvard] as a quid-pro-quo for being relieved of a burden that it would otherwise have to assume."[132] The same is true for the federal income tax: "The establishment and maintenance of institutions of higher education is certainly not the responsibility of the federal government."[133] Moreover, while a greater correlation may exist between the local government burden (represented by property tax exemption) and private primary or secondary schools, the connection between these schools and state and federal *income tax* exemption is even more remote.

Another proportionality problem is that the financial benefit resulting from tax exemption is almost entirely unrelated to the costs of providing the

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128. *See* SALAMON, *supra* note 1, at 77; Hansmann II, *supra* note 6, at 67–71; Atkinson, *supra* note 6, at 15.

129. Simon, *supra* note 5, at 77.

130. *See* Marc Bendick, Jr., *Education as a Three Sector Industry, in* THE VOLUNTARY NONPROFIT SECTOR 101, 110, 129 (Burton A. Weisbrod ed., 1977) (tables showing size of for-profit sector in comparison to government and nonprofit sector); Levy, *supra* note 2, at 6–8.

131. Another classic problem with the quid-pro-quo theory and the need criterion is that of exempt religious institutions. One can hardly claim that government grants exemption to religious institutions as a quid-pro-quo for relieving a government burden of providing religion, inasmuch as government is constitutionally prohibited from doing so. *See* Hall & Colombo II, *supra* note 14, at 359.

132. Belknap, *supra* note 7, at 2033. The fact that local communities do not believe in the "quid-pro-quo" theory is evident from the many communities that have sought and obtained voluntary payments in lieu of taxes from such institutions. *See supra* note 122.

133. Belknap, *supra* note 7, at 2033.

services. As discussed above, tax exemption may be viewed as a government subsidy that correlates roughly to retained earnings.[134] In essence, an income tax exemption subsidizes those entities that charge more for their services than cost, since if the entity were operating on a "break even" basis, there would be no income to tax, and hence no benefit from an income tax exemption. At the property tax level, the exemption provides a subsidy to the entities with the greatest capital investment, which both bears little relationship to the costs of providing educational services, and also provides the greatest benefit to those institutions that have the greatest revenue surpluses to invest in capital items.[135]

Finally, the theory fails on the historical consistency criterion because it does not even come close to explaining the traditional scope of the educational exemption. While one might view traditional schools as a necessary government function and argue that traditional private schools relieve the government from the burden of educating those students attending private schools, the quid-pro-quo theory fails to address the myriad of nontraditional educational activities that historically have been exempt but are not government responsibilities. Organizations that disseminate information, for example, historically have fallen into the educational ambit, but one would have a hard time arguing that in absence of these organizations, the government would be required to spend tax dollars to disseminate information about model housing programs,[136] the advantages of street planning,[137] or the accuracy of news coverage by newspapers.[138] Nor would one find an affirmative government obligation to support instruction in securities management,[139] drag car and sailboat racing,[140] or dancing.[141] While some of these organizations in fact may not deserve exemption under any theory, limiting exemption to true quid-pro-quo situations would both unduly restrict the exemption in terms of activities exempted and, if followed to logical conclusion, unduly expand the exemption to for-profit providers of activities within the ambit of the quid-pro-quo rationale.

2. The Community Benefit Theory

While the quid-pro-quo theory at one time was the most cited reason for exemption, that theory largely has been displaced in popularity today by the community benefit theory. This theory claims that exemption is warranted not as a direct quid-pro-quo for goods or services that the government otherwise would have to provide, but rather as government support for institutions that provide socially worthy goods or services with a special quality or ethic. Often this theory is expressed in terms of the way nonprofit organizations contribute to pluralism by providing the public goods and services that either are

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134. Hansmann II, *supra* note 6, at 59–61, 71.
135. *See Alternatives to the University Property Tax Exemption, supra* note 123, at 183. Of course, *some* correlation exists between the property tax exemption and the quid-pro-quo theory. To the extent that one accepts the notion that the educational services in question would have to be undertaken by the government in the absence of the exempt institution, presumably the government would need some capital investment of its own that then would not be taxed.
136. Rev. Rul. 68–17, 1968–1 C.B. 247; Rev. Rul. 67–138, 1967–1 C.B. 139.
137. Rev. Rul. 68–14, 1968–1 C.B. 243.
138. Rev. Rul. 74–615, 1974–2 C.B. 165.
139. Rev. Rul. 68–16, 1968–1 C.B. 246.
140. Rev. Rul. 64–275, 1964–2 C.B. 142; Lions Associated Drag Strip v. United States, 64–1 T.C. (CCH) ¶ 9283 (S.D. Cal. 1963).
141. Rev. Rul. 65–270, 1965–2 C.B. 160.

undersupplied by the private market or by the government or else not provided in the same socially desirable manner. Professor Atkinson has described the basis of the community benefit theory as the notion that charities provide "metabenefits" that result not from the product or service provided by the exempt entity, but from the *way* such product or service is provided or from the very existence of the exempt provider.[142] As Bruce Hopkins has stated, exemptions are "a bulwark against overdomination by government and a hallmark of a free society; they help nourish the voluntary sector of this nation and preserve individual initiative, and reflect the pluralistic philosophy that has been the guiding spirit of democratic America."[143]

While the community benefit theory has had its most explicit delineation in the context of exemption for nonprofit hospitals and health care providers,[144] the same points made in the hospital context concerning the special role of private nonprofit entities have also been made, albeit in different contexts, with respect to educational institutions (at least, private nonprofit schools). Thus private schools have been defended on the grounds that they promote parental choice in education, promote diversity in schooling and in society as a whole, provide wider opportunities for the socially disadvantaged, and provide better quality education than their public counterparts.[145]

As an exemption theory, however, the community benefit doctrine suffers many of the same problems as the quid-pro-quo theory, as well as some new ones. Perhaps the most serious of these is the inherent inability to quantify the particular ethic or quality that results in exemption, and thus to properly identify when exemption is deserved. Boris Bittker and George Rahdert observed, "Lacking a method for measuring these appealing but elusive virtues, one must perforce rely on intuition in comparing the achievements of private charities with those of government, when they are performing similar functions."[146] Other commentators have referred to the community benefit standard as "existential,"[147] relying on concepts with "vague, emotive meanings" that

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142. Atkinson, *supra* note 6, at 605–06 n.266 (1990).

143. HOPKINS, *supra* note 20, at 62. Commentators fond of the community benefit approach tend to wax eloquent in its defense. *See* Trustees of the First Methodist Episcopal Church v. City of Atlanta, 76 Ga. 181 (1886), in which the judge stated that exemption promotes values

> such as benevolence, charity, generosity, love of our fellowmen, ... and all those comely virtues and amiable qualities which clothe life "in decent drapery" and impart a charm to existence, ... furnish a sure basis on which the fabric of civil society can rest, and without which it could not endure. Take from it these supports, and it would tumble into chaos and ruin. Anarchy would follow order and regularity, and liberty, freed from its restraining influence, would soon degenerate into the wildest license, which would convert the beautiful earth into a howling pandemonium, fit only for the habitation of savage beasts and more savage men.

Id. at 192–93. *See also* Belknap, *supra* note 7, at 2033–35 (exemption exists because government wishes to encourage charitable activities "as representing the highest and noblest achievements of mankind ... activities which by common understanding are agreed to rate among the highest in the scale of social values.").

144. *See* Hall & Colombo II, *supra* note 14, at 364–84, and sources cited therein.

145. *E.g.*, Hirschoff, *supra* note 77, at 40–43; James G. Cibulka, *Rationales for Private Schools: A Commentary, in* PRIVATE SCHOOLS AND PUBLIC POLICY: INTERNATIONAL PERSPECTIVES 91–104 (William Lowe Boyd & James G. Cibulka eds., 1989).

146. Bittker & Rahdert, *supra* note 6, at 332–33.

147. Robert L. Bromberg, *The Charitable Hospital,* 20 CATH. L. REV. 237, 248–51 (1970).

express "rhetoric of intention ... rather than any exact program or method"[148] and as an "opiate" that deludes people.[149]

In the educational area, for example, the special qualities cited in support of private nonprofit schools would seem to be equally applicable to for-profit counterparts: the existence of for-profit private schools also would increase parental choice, educational opportunity and promote diversity.[150] Similarly, in higher education at least, some government institutions might supply many or all of these same qualities: surely whatever "special ethic" Harvard and other premier private institutions bring to higher education can be found as well in the premier *public* institutions such as Berkeley, Illinois, Michigan, Texas, Virginia and the like. Education researchers, in fact, are skeptical that private schools in general provide much, if any, quality improvement over government counterparts, despite common perceptions to the contrary.[151]

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148. ROBERT STEVENS, IN SICKNESS AND IN WEALTH: AMERICAN HOSPITALS IN THE TWENTIETH CENTURY 354 (1989).

149. Uwe E. Reinhardt, *Charity at a Price*, N.Y. TIMES BOOK REV., Aug. 20, 1989, at 14 (the "ideals of private charity and voluntarism ... act as the opiate of the American public, deluding a basically decent people into believing that ... deeply troubling social problems requiring whole dollars for their solution can ... be adequately addressed with just two bits' worth of trickle-down generosity ....").

J. David Seay, on the other hand, claims that the community benefit standard need not be inherently vague, and has proposed specific process-based criteria for exemption of hospitals. J. David Seay & Robert M. Sigmund, *Community Benefit Standards for Hospitals: Perceptions and Performance*, FRONTIERS HEALTH SERVICES MANAGEMENT, Spring 1989, at 30; J. David Seay, *Tax Exemption for Hospitals: Towards an Understanding of Community Benefit*, 2 HEALTH MATRIX 35, 45–48 (1992). According to Seay, the key elements of this standard are that hospitals have processes to identify community needs and develop programs to meet those needs. But as Professor Hall and I previously have observed, this process-based standard does not attempt to quantify the community need nor assess whether nonprofits outperform for-profits in this regard. Hall & Colombo II, *supra* note 14, at 378. One can argue, in fact, that for-profit institutions are likely to be *more* responsive to community needs, since for-profits rely on customer patronage for financial success, and customer patronage requires selling a product the customer wants. Economic theory, in fact, supports the notion that in most cases "profit-seeking firms will supply goods and services at the quantity and price that represent maximum social efficiency." Hansmann I, *supra* note 6, at 843.

150. For example, Daniel Levy notes that for-profit schools may be freer from government regulation than nonprofit counterparts, have smaller classes and be more job-oriented than their nonprofit counterparts, all characteristics that would appear to promote choice and diversity in education. Levy, *supra* note 2, at 8. Moreover, since for-profit institutions dominate the vocational training sector of education, *supra* text accompanying note 128, they clearly address an educational need that is not being addressed by nonprofit schools. *See also* Bendick, *supra* note 6, at 101 (illustrating differences in course offerings, extracurricular activities, and so forth among for-profit, nonprofit and public schools).

Levy does note that little research exists on the relative merits of for-profit versus nonprofit schools. In this regard, he speculates that if the for-profit sector were to expand, nonprofit schools might well respond by emphasizing their special nonprofit qualities. Levy, *supra* note 2, at 7. This, of course, is exactly what has happened in the nonprofit hospital area: as the for-profit health care sector has expanded, nonprofit traditionalists have tried to define more explicitly the qualities of nonprofit health care that make it more desirable than the for-profit model. *See generally* Hall & Colombo II, *supra* note 14, at 367–77, and sources cited therein.

151. Richard J. Murnane, *Comparisons of Private and Public Schools: What Can We Learn?*, in PRIVATE EDUCATION: STUDIES IN CHOICE AND PUBLIC POLICY 153, 162 (Daniel C. Levy ed., 1986) (education researchers agree "that even the largest estimates of a private school advantage are small relative to the variation in quality among different [schools]."); J. Douglas Willms, *Do Private Schools Produce Higher Levels of Academic Achievement? New Evidence for the Tuition Tax Credit Debate*, in PUBLIC DOLLARS FOR PRIVATE SCHOOLS: THE CASE OF TUITION TAX CREDITS 223 (Thomas James & Henry M. Levin eds., 1983) (noting

The vagueness of the community benefit standard is especially troubling because it takes the substantive policy decisions regarding what activities are so socially desirable as to deserve exemption out of the hands of Congress, state legislatures, or other government agencies charged with substantive policy decisions and puts such decisions in the hands of the IRS or state taxing authorities, all primarily charged with the task of tax collection.[152] In the education area, this has resulted in the decisional morass described in Part II of this Article. Lacking the expertise or mandate to make sensible substantive decisions concerning exemption, taxing authorities turn to inherently vague limiting concepts such as "commerciality," "private benefit," and "propaganda" to police the area with contradictory results.[153] As a limiting principle on exemption of educational institutions (or on exemption generally), therefore, the community benefit standard leaves much to be desired.

The community benefit standard suffers from other problems, as well. Like the quid-pro-quo standard, it fails the proportionality criterion because it is no better at matching the level of "special ethic" of the exempt entity to the value of the exemption. Indeed, no specific reason exists to believe that whatever special qualities nonprofit enterprise brings to the educational sector would not exist absent exemption. Put positively, the argument is as follows. If consumers prefer the special ethic in education provided by Harvard, why would they not continue to prefer Harvard even absent exemption? Would Harvard really go out of business if it were not tax exempt? True, absent exemption a Harvard education might cost more than it does now, thus restricting the number of students who could afford to go there. If this is a legitimate government concern, however, it can be addressed more directly (and infinitely more efficiently, since under the current scheme no assurances exist that the economic benefits of exemption result in lower prices to students—it might equally result in higher salaries for professors) by simply providing needy students with direct government grants or other financial aid.[154] As Burton Weisbrod observed, "Public policy can be devised simply to permit nonprofit organizations to exist; to permit nonprofits to compete with for-profit firms; to provide for public subsidies of nonprofits, or to provide for specific forms of subsidies ...."[155] If the major problem with higher education is that the full cost would be prohibitively expensive for most students, a specific form of government subsidy targeted at that particular problem is a far better way to allocate

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that two national studies produced different results on the issue). This debate mirrors that in the health care industry, where the virtues of nonprofit hospitals have come under increasing attack. *See generally* Hall & Colombo II, *supra* note 14, at 355–74, and sources cited therein.

152.   *See* Persons et al., *supra* note 7, at 1942 (IRS is the "arbiter of the public good"); Warren et al., *supra* note 10, 302, 309 (1971) (describing state property tax exemptions as "legislative abdication" of difficult policy decisions to tax collection machinery).

153.   *Supra* text accompanying note 89; *see* Tommy F. Thompson, *The Unadministrability of the Federal Charitable Tax Exemption: Causes, Effects and Remedies,* 5 VA. TAX REV. 1, 56 (1985) (accusing IRS of abandoning any attempt to administer the exemption and treating cases on an "ad hoc, nonanalytical basis ... using definitional strategies based on subjective, unarticulated factors rather than on objective, verifiable criteria.").

154.   In fact, Professor Hansmann has theorized that the substantial donations that characterize most nonprofit colleges and universities are a private mechanism to help students finance their education, made necessary by the government's and private market's failure to provide an adequate system of student loans. Hansmann I, *supra* note 6, at 860.

155.   BURTON WEISBROD, THE NONPROFIT ECONOMY 88 (1988).

government resources than the scattershot vehicle of exemption.[156]

3. Hansmann's Capital Subsidy Theory

Faced with the deficiencies in the theories examined so far, Professor Henry Hansmann devised an alternate theory of exemption based on the notion that exemption assists nonprofits in overcoming barriers to accessing capital markets. According to Hansmann, nonprofit firms exist primarily in markets characterized by "contract failure"—that is, a failure of the private market to function properly.[157] Contract failure occurs when consumers of a product or service have difficulty either in comparing the quality of performance offered by competing providers before a purchase is made or in determining after a purchase whether the service was actually performed as promised.[158] Hansmann's classic examples are CARE and The Red Cross: in each of these cases, the "purchasers" (donors to the entity) purchase relief for third parties. The donor/purchasers, however, have no way to evaluate whether the promised relief services are actually delivered, because the parties actually "consuming" the relief services are not the purchasers but third parties often located in remote areas of the world.[159] The purchasers, therefore, are more likely to trust a nonprofit firm for these services, because one of the elements of non-profit status is a prohibition on the entity distributing revenues to its managers/founders—what Hansmann refers to as the "nondistribution con-straint."[160] Because an exempt entity cannot legally divert its revenues to its managers/founders, the donor/purchasers have some reason to believe that the revenues they provide actually will be used to provide the service they have purchased, even though independent verification is difficult or impossible.[161] Thus in cases of contract failure, nonprofit firms serve the public's needs more efficiently than for-profit providers.

According to Hansmann, contract failure is most evident with respect to entities that are engaged in the production of public goods. The private market fails to function with respect to public goods because it costs no more to ·provide such goods to many consumers than to one and the nature of such goods is that once they are produced for one consumer, it is impossible to prevent other consumers from enjoying their benefits (a characteristic referred to by economists as "indivisibility").[162] Thus no individual consumer has an

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156. In fact, specific government subsidies for private schools already exist. These include government-subsidized transportation, grants for handicapped and special education, government-provided secular textbooks, government-provided health and hygiene services such as nurse visits, immunization programs and the like, guidance and counseling services, scholarship programs and others. *See generally* Dennis J. Encarnation, *Public Finance and Regulation of Nonpublic Education: Retrospect and Prospect, in* PUBLIC DOLLARS FOR PRIVATE SCHOOLS 175, 179–87 (Thomas James & Henry M. Levin eds., 1983); NATIONAL CTR. FOR EDUC. STATISTICS, FEDERAL SUPPORT FOR EDUCATION FISCAL YEARS 1980–1992 (detailing federal programs for support of education generally).

157. Hansmann II, *supra* note 6, at 69; Hansmann I, *supra* note 6, at 843–45; *see generally* Atkinson, *supra* note 6, at 602–05; Hall & Colombo II, *supra* note 14, at 387–89.

158. Hansmann II, *supra* note 6, at 69.

159. *Id.; see* Hansmann I, *supra* note 6, at 846–48.

160. Hansmann II, *supra* note 6, at 56; *see* Hansmann I, *supra* note 6, at 838. The nondistribution principle is contained in I.R.C. § 501(c)(3) (1988) (the statutory prohibition on private inurement) and in state law by virtue of either state nonprofit corporation laws or, in the case of unincorporated enterprises, the common law of charitable trusts.

161. Hansmann II, *supra* note 6, at 69–70; Hansmann I, *supra* note 6, at 843–45.

162. Hansmann I, *supra* note 6, at 848.

incentive to pay for the good, because that consumer cannot prevent others from "free riding" on the purchase. Air pollution control is one classic example: it costs no more to clean up the air in Los Angeles for one resident than for the entire population, and once clean, the entire population can enjoy the benefits.[163] For such reasons, public goods often are financed by the government, which can coerce payment through its taxing power.

Pure public goods, however, are rare, if they exist at all. Instead, many goods and services are hybrids, in which the private market functions, but imperfectly. Disaster relief provided by the Red Cross is one example. The services provided by the Red Cross are not true public goods because there is a marginal cost to providing services to additional beneficiaries, and some of the services are "beneficiary specific" so that one person cannot enjoy the relief given another. Nevertheless, the separation between the purchaser (the donor to the Red Cross) and the consumer (the disaster relief beneficiary) creates an imperfect market mechanism.[164] A third case of contract failure, according to Hansmann, exists in the area of "complex personal services" such as education, where comparisons of quality between providers is difficult.[165]

While the contract failure hypothesis may explain why nonprofit firms exist in particular markets, it fails to explain exemption. Under Hansmann's theory, nonprofit firms exist in markets characterized by contract failure because they are preferred by purchasers of their services. Presumably, this preference would exist regardless whether the nonprofit provider received tax exemption. Hence, no necessary connection exists between Hansmann's rationale for the existence of nonprofit firms and the government's grant of exemption. This latter issue Hansmann resolves by noting that because of the nondistribution constraint, a nonprofit firm cannot access public capital markets by issuing shares to investors.[166] Instead, nonprofit firms are limited to debt, donations, and retained earnings as capital sources.[167] The exemption, therefore, serves as a capital formation subsidy by permitting nonprofit firms to accumulate capital surplus free of taxes.[168] Hansmann goes on to explain that in ideal market conditions, the income tax exemption provides the greatest subsidy in times of increasing demand for a nonprofit's services, because increasing demand will result in greater revenue, and hence a larger subsidy. Conversely, as demand falls off, revenues will also, and the subsidy effect decreases. According to Hansmann, this result is appropriate because the capital needs of the nonprofit provider will be highest in times of increasing demand, and, conversely, lowest

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163. *Id.*
164. Hansmann I, *supra* note 6, at 846–48; *see* Atkinson, *supra* note 6, at 515–17.
165. Hansmann I, *supra* note 6, at 865–66; *see* Atkinson, *supra* note 6, at 517–18. Hansmann also contends that education suffers from the "market separation" phenomenon, because the purchasers of education services often are parents, while the consumers are their children. Hansmann I, *supra* note 6, at 865–66. One could also view education as a type of public good to the extent that educating individuals makes society better off.
166. Hansmann II, *supra* note 6, at 72–75; *see* Atkinson, *supra* note 6, at 602–03.
167. Hansmann II, *supra* note 6, at 72; *see* Atkinson, *supra* note 6, at 602.
168. The value of this subsidy is proportional to the tax rate. At the current maximum corporate tax rate of 34%, I.R.C. § 11 (1988), the exemption is worth $.34 on each dollar of retained earnings at the federal level. In addition, of course, would be the subsidy that exists as a result of state income tax exemption, and, to the extent such surplus is invested in taxable property, an additional subsidy arises from state property tax exemption.

in times of decreasing demand.[169]

While Hansmann's theory provides an elegant explanation for why non-profits exist in certain markets, the capital subsidy hypothesis for the exemption suffers numerous problems, especially in the educational area. First, one suspects that less contract failure occurs in the educational market than Hansmann theorizes. Hansmann claims that education suffers from two of the three forms of contract failure: the market separation problem that results from parents purchasing education for third-party consumers and the evaluation problem that results from education as a complex personal service, where quality comparison is difficult. Market separation, however, certainly is less a problem at the college/university level, where substantial numbers of students pay for their own education through loans, grants and work. While no one doubts parental contributions to college educations, it seems absurd to view the parents as the primary purchasers of college services. Moreover, while quality comparisons with respect to educational institutions may be more difficult than choosing Wendy's over McDonald's for lunch, students (and parents) certainly do it, assisted by any number of private "rankings," guidebooks and the like.[170] Professor Ellman has observed that even at the primary and secondary educa-tion levels, parents likely engage in far more quality evaluation than Hansmann appears to credit.[171]

Second, exemption operates as an "extremely crude mechanism" for conferring a capital subsidy.[172] If nonprofit firms face capital formation problems sufficient to warrant government intervention, a far more precise mechanism would be direct government construction grants, government-assisted loans or tax incentives targeted at capital formation. In fact, the educa-tional sector has benefited from all these types of government capital assistance. Tax-exempt bond financing available under Code § 145 permits exempt organi-zations to borrow money on terms more favorable than for-profit counterparts, a benefit that private schools have used extensively.[173] Both the federal

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169. Hansmann II, *supra* note 6, at 76–85.
170. *E.g.*, BARRON'S EDUCATIONAL SERIES, INC., BARRON'S PROFILES OF AMERICAN COLLEGES (19th ed., 1992); JAMES CASS & MAX BIRNBAUM, COMPARATIVE GUIDE TO AMERICAN COLLEGES (15th ed., 1991); COLLEGE BOARD, THE COLLEGE HANDBOOK 1993 (1992); PETERSON'S GUIDE TO FOUR-YEAR COLLEGES 1993 (Susan W. Dilts ed., 1991); EDWARD B. FISKE, THE FISKE GUIDE TO COLLEGES 1993 (1992); EDUCATIONAL RANKINGS ANNUAL 1991 (Lynn C. Hattendorf ed., 1991); MACMILLAN PUBLISHING CO., THE COLLEGE BLUEBOOK (23d ed., 1991); CHARLES T. STRAUGHN II & BARBARASUE LOVEJOY STRAUGHN, LOVEJOY'S COLLEGE GUIDE (21st ed., 1992); *see* Atkinson, *supra* note 6, at 573 (opining that quality of higher education relatively easy to monitor).
171. *See* Ira M. Ellman, *Another Theory of Nonprofit Corporations*, 80 MICH. L. REV. 999, 1033 (1982) ("In fact, one's general impression is that, whether or not they are right, parents tend to think that they know whether their child's school or day care facility is doing a good job."). Ellman reports that data collected by Jamie Newton in San Francisco tends to support the proposition that parents at least *believe* they can monitor the quality of their child's day care. This view is also consistent with the historic development of private schools as refuges from what parents perceived as educational or social policies incompatible with their own beliefs. *See supra* note 76.
172. Hansmann II, *supra* note 6, at 92.
173. According to the 1993 U.S. Budget, the "outlay equivalent" for the exclusion of interest on state and local bonds for private nonprofit educational facilities was $765 million in 1993, $725 million in 1992, and $690 million in 1991. U.S. OFFICE OF MANAGEMENT AND BUDGET, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 1993, tbl. 24–1, at 2–27 (1992).

government and states, moreover, provide direct subsidies for the costs of building facilities for handicapped students, free textbooks and instructional materials, and transportation services that otherwise would require substantial capital investment.[174] In short, at least as applied to educational institutions, Hansmann's theory fails to explain why direct government subsidies, which in fact are quite common in the educational sector, are not better ways of attacking capital problems.

Third, Hansmann fails to offer any objective, administrable criteria for determining when particular organizations are experiencing capital funding problems. The traditionally tax-exempt hospital industry, for example, appears not to have a capital formation problem at all.[175] In the education area, capital access problems are more difficult to assess. Major universities appear quite successful in attracting major capital infusions by donation through "capital campaigns," although the past few years have seen funding crises even at elite institutions such as Yale. These crises, however, appear to relate more to annual operating costs than the need for greater capital investment. Moreover, one senses that the capital needs of other educational institutions, such as information-dissemination organizations, propaganda organizations and the like, are quite limited.

Finally, Hansmann's capital subsidy theory does not provide a satisfactory explanation of state property tax exemption. Although Hansmann argues that the capital subsidy theory can be applied to state property tax exemption,[176] the property tax exemption would appear to provide the greatest subsidization to those entities that already have the largest capital base—that is, the most taxable property. In this case the exemption would appear to operate inversely to capital needs.

In short, Hansmann's capital subsidy theory appears to fail on deservedness, proportionality and universality grounds. It fails to track when an exemption is deserved because it offers no explanation for why capital formation problems are not better addressed through direct government intervention (as has often been the case in education), it fails to provide any meaningful standard for determining when capital formation problems exist (does Harvard really have a problem attracting capital?), and it fails to provide an adequate explanation for state property tax exemption.

4. Atkinson's Altruism Theory

After Hansmann's work in the early 1980s, nearly a decade passed until the next major academic consideration of tax exemption. In 1990, however, Professor Rob Atkinson set forth the theory that exemption was a proper government encouragement of altruism.[177] Criticizing Hansmann's contract failure/capital subsidy theory as too narrow, Atkinson theorizes that all nonprofit organizations other than "mutual commercial nonprofits" (entities in which the founders directly benefit from the firm's production, such as parent-

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174. *See* WEISBROD, *supra* note 155.
175. Hall & Colombo II, *supra* note 14, at 388. Hansmann admits this, in fact, and suggests that the hospital industry may be an example of an industry no longer in need of exemption. Hansmann II, *supra* note 6, at 89.
176. Hansmann II, *supra* note 6, at 93.
177. Atkinson, *supra* note 6.

controlled day care) exhibit a form of altruism. In donative entities, the altruism is obvious: donors providing funds for services to third parties. Even in commercial nonprofits, however, Atkinson finds altruism in the founder's decision to forego profits and conduct business in the nonprofit form, since the profits that would have been available to the founder can now be used to subsidize consumption by others.[178] Because altruism is something that is (or should be) highly valued by society, the exemption is deserved as government encouragement of this valued attribute of nonprofits.[179]

Atkinson's theory has the great benefit of certainty and administrability, items lacking in any of the theories advanced so far. In essence, Atkinson would grant exemption to any nonprofit entity other than the "mutual commercial nonprofit" he identifies. This certainly takes the IRS out of the business of subjectively judging what activities deserve exemption. It also expands the exemption beyond any current boundary, and as with other theories examined so far, has some major definitional problems.

First, one may legitimately question whether Atkinson is correct in asserting that the decision by an organizer to choose the nonprofit form and hence forego future profit opportunities is, in fact, an "altruistic" one in all cases other than mutual benefit nonprofits. Other commentators have offered a variety of rationales for why organizers might choose the nonprofit form not out of altruistic motives but purely self-serving ones. In the hospital industry, for example, many commentators conclude that hospitals adopt the nonprofit form because doctors prefer it, not because of altruistic motivation.[180] In labor intensive service businesses that can pay out virtually all the net revenues as salaries to employees, an exemption would provide more such revenues—in essence a distribution of profit, though one not prohibited by nonprofit corporate or tax law as long as the salary is "reasonable."[181]

A related problem is that Atkinson assumes that a one-time decision to forego profits justifies exemption essentially forever. Even if one agrees that an initial decision to forego profits is altruistic, as a matter of fiscal policy surely we should not grant exemption in perpetuity with no right to reconsider whether the initial decision is still relevant in terms of today's needs. Racially segregated parks and swimming pools were once legitimate targets of philanthropy;[182] presumably, even Atkinson would admit that societal mores have changed to the point that we would no longer consider a government subsidy

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178. *Id.* at 553.
179. *Id.* at 628.
180. *See* Hall & Colombo II, *supra* note 14, at 367–74, and sources cited therein.
181. Hall & Colombo, *supra* note 6, at 1419–20. To be fair, Professor Atkinson does recognize that certain nonprofits may exhibit a material quid-pro-quo for their managers, and would deny exemption in these cases. Atkinson, *supra* note 6, at 544–45 n.125, 553–54 (doctor controlled hospitals). He does not, however, provide any operational criteria to distinguish such organizations, although he does believe that such criteria could be developed (donations, perhaps?). *Id.* at 554.
182.   The famous case of Senator Augustus O. Bacon of Georgia is one example. Upon his death, Senator Bacon left a large tract of land to the city of Macon, Georgia, for use as a segregated park. When African-Americans sought admission to the park in 1963, litigation ensued which ultimately ended in the United States Supreme Court ordering desegregation of the park. Evans v. Newton, 382 U.S. 296 (1966). In its discussion concerning whether the administration of the park constituted "state action" subject to the Fourteenth Amendment, the Court noted that the park enjoyed tax-exempt status. *Id.* at 301.

for such activities.[183]

Finally, even if one agrees with Atkinson that adoption of the nonprofit form is itself altruistic, he offers no explanation for why exemption is a necessary or even appropriate response to his perceived altruism—in short, no reason for why an exemption is deserved. Atkinson, in fact, admits this, stating that it would be "logical" for him "to prove that altruism really is a good thing and thus worthy of tax favors" but declining to do so as "too ambitious."[184] Instead, he leaves the connection between altruism and tax exemption to "faith [and] freely chosen values and visions." The result, of course, is that anyone choosing the nonprofit form of business automatically qualifies for exemption; applied to educational institutions, this would result in a definition broader than that already used by the IRS, without any of the limiting principles.[185] While one hates to criticize faith and freely chosen values, my own faith does not extend to granting government subsidization to organizations giving professional seminars to doctors, lawyers and bankers. They can pay for their own faith and freely chosen values.

5. The Donative Theory

The subsidy theories of exemption examined so far all suffer from serious defects in either deservedness, proportionality or both. In addition, the two most popular theories, the community benefit theory and Hansmann's capital subsidy theory, lack any objective criteria for determining eligibility for exemption that can be administered by the IRS. Faced with this situation, Professor Mark Hall and I revisited the theoretical grounds for exemption and noted, curiously, that virtually all commentators agreed that "donative entities" (whatever they were)[186] were clearly deserving of exemption; the commentators then devoted most of their energy to developing a rationale for exempting other kinds of nonprofits. We decided on a different approach: if everyone appeared to agree that donative entities were deserving of exemption but disagreed about others, perhaps donations were the key to an objective, admin-

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183. *See* Atkinson, *supra* note 6, at 636–37 (possible room for public policy doctrine in the altruism theory as an "extraneous" constraint).

184. *Id.* at 628. In a later article on morality and ethics, Atkinson does further explain his position that these matters are simply incapable of objective proof and thus must rest with shared personal commitment. Rob Atkinson, *Beyond the New Role Morality for Lawyers*, 51 MD. L. REV. 853, 872–89. In a broad sense, I agree. In matters of tax administration, however, I have a bedrock commitment to objective, administrable standards regarding when entities should pay taxes and when they should not; and I desperately believe in keeping the Internal Revenue Service and the Department of the Treasury, as entities, out of our Socratic sharing of values and beliefs. *E.g., id.* at 977–79. My criticism, placed in a somewhat humorous light in the next few sentences of text, is that the failure to provide objective standards to guide the conduct of tax enforcement will lead to exactly the type of morass and contradictory decision making that typifies the educational exemption. The donative theory offers such an objective standard that in effect is tied to the altruistic behavior both Atkinson and I value as moral points; it also, I believe, has good grounding in economic theory (which at least ought to be *considered* in a system that purports to have as its primary objective the collection of revenue) and political reality (ditto).

185. Except, perhaps, for the public policy limitation. *See supra* note 183.

186. Prior to our second article, Hall & Colombo II, *supra* note 14, no one had seriously attempted to define what a donative entity was, although examples (such as CARE and the Red Cross) certainly abounded. Moreover, the commentators sometimes classified entities as donative without really examining the statistical evidence. As discussed below, this is certainly the case with educational institutions, many of which are far less dependent on donations for financing than one might believe.

istrable standard for granting exemption. In short, instead of trying to justify expanding exemption beyond the donative standard, we embarked on justifying *limiting* the exemption to *only* donative entities. Our theory thus posits that exemption should be available only when a given percentage of an entity's revenues come from donations.

a. The Economic Basis for the Donative Theory

The donative theory begins with Professor Hansmann's observation that nonprofits tend to exist in markets characterized by contract failure—that is, a failure of the private market to function properly. This observation, however, fails to explain why nonprofits in these markets deserve the benefit of tax exemption. If Hansmann is correct in his observation that consumers prefer the nonprofit form of enterprise in markets characterized by contract failure, then nonprofit entities should proliferate in these markets even absent exemption.[187] Hansmann's response is that the exemption serves as a capital formation subsidy. As noted above, however, it is not at all clear that many traditionally-exempt entities, including hospitals and at least some educational institutions, suffer from capital attraction problems; even if they do, Hansmann offers no rationale regarding why exemption, rather than a direct government subsidy to assist capital attraction, is the appropriate policy.[188] This latter point is the key question. In order to satisfy the deservedness criterion, a theory of exemption must explain why exemption, rather than direct government intervention, is an appropriate response. The donative theory does just that, because it posits that exemption is warranted not in all cases of private market failure, but *only* in those cases in which private market failure *is accompanied by government failure*, i.e., a failure of the government to intervene directly to provide the optimal level of production.[189]

Government failure occurs as a result of the vagaries of the democratic system, which requires a majority vote of the legislature to enact government programs. Economist Burton Weisbrod observed that because of this phenomenon, minority blocs of voters will lack the voting strength to force the government to meet their demand for certain goods and services.[190] In effect, the government will provide any good or service at approximately the demand of the median voter, since any attempt to provide more than this will be voted down by the majority.[191] The result, of course, is that high-demanding minority blocs will be chronically underserved.

It is this "twin failure" scenario (private market failure coupled with government failure) that justifies exemption, because it answers the question why direct government intervention is not a more appropriate response to private market failure. When twin failure occurs, there *cannot be* any direct

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187.   *See* Hansmann II, *supra* note 14, at 70–71 ("not obvious why a subsidy is needed to encourage nonprofits even where their development seems appropriate as a response to contract failure").

188.   See *supra* text accompanying notes 172–74.

189.   *See* Hall & Colombo II, *supra* note 14, at 391.

190.   Burton A. Weisbrod, *Toward a Theory of the Voluntary Nonprofit Sector in a Three-Sector Economy, in* THE VOLUNTARY NONPROFIT SECTOR 51, 53–61 (Burton A. Weisbrod ed., 1977) [hereinafter *Nonprofit Sector*]; BURTON A. WEISBROD, THE NONPROFIT ECONOMY 25–31 (1988) [hereinafter NONPROFIT ECONOMY].

191.   Hall & Colombo II, *supra* note 14, at 392–96.

government intervention because the majority of the electorate will not vote for it. Why, then, would the majority permit exemption, which constitutes an indirect government subsidy?

The answer here is that although a majority of voters may resist paying the full cost of government directly providing certain goods and services, a majority may be willing for government to "contribute" to such production because, while they do not value the particular good or service enough to pay for all of it, they recognize that they would receive some marginal benefit from increased production and hence would be willing to pay for a portion of that increased production, especially if such agreement would permit a partial cross-subsidy of their own special interest.[192] Because exemption is "worth" only the tax rate on taxable income or property, it is only a fraction of the cost of direct government provision of the desired goods and services; accordingly, consumers who do not value a particular good or service enough to pay for its full cost but attach some marginal value to increased production should be willing to use exemption to accomplish this purpose. Moreover, even those consumers who attach no value to increased production of a particular good in isolation might go along with a partial subsidy of that production as a political cost of receiving their cross-subsidy. Viewed in this light, exemption is a sort of "I'll scratch your back if you'll scratch mine" social compact among high-demanding groups with widely divergent preferences. Opera lovers are not willing to pay the full cost of the government studying ruffled grouse and vice-versa; but many ruffled-grouse lovers wouldn't mind paying a little for more opera, and many opera lovers wouldn't mind paying a little for a bit of ruffled grouse study, especially if the bargain results in each group getting some help for its own preferred interest. Because everyone that has a particular interest subject to government failure benefits from exemption, and because virtually all segments of society either have such an interest or directly benefit from such an interest,[193] from the standpoint of social policy exemption becomes a method for government to assist *all* of society in providing goods and services that the private market cannot provide (since by definition we are dealing with a private market failure situation), and which the government cannot fully provide directly because of structural deficiencies in the democratic system.[194]

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192. *Nonprofit Sector*, *supra* note 190, at 66. Think of a typical demand curve, in which demand increases as price decreases. If we replace "price" with "tax cost," then demand will increase as the tax cost decreases. Thus as one moves from government providing the full cost of additional production to a cost of, say, $.30 on the dollar, demand will increase. See generally Hall & Colombo II, *supra* note 14, at 392–96, for graphs illustrating this point.

193. As noted below, I use donations as a signal that a group has unmet demands for an entity's goods or services, and the vast majority of United States residents donate to some exempt organization. A 1989 Gallup poll on contributions and volunteering, for example, found that 75.1% of all households surveyed contributed to some exempt organization. VIRGINIA A. HODGKINSON & MURRAY S. WEITZMAN, GIVING AND VOLUNTEERING IN THE UNITED STATES 25, tbl. 1.1 (1990). As might be expected, contribution activity varied significantly by income level with households reporting income of under $10,000 per year having the lowest percentage of contributions (49%). *Id.* at 55, tbl. 2.1. Even at the relatively modest income level of $10,000 to $20,000, however, 65.1% of surveyed households made donations. Thus even the relatively poor have special demands for goods and services signified by their donative activity. Moreover, a number of donative institutions directly aid the poor (the United Way, the Salvation Army, etc.); thus although lower income households donate at a lower rate, they tend to be the beneficiaries of donations.

194. *See* NONPROFIT ECONOMY, *supra* note 190, at 25–26; *Nonprofit Sector*, *supra* note 190, at 51.

b. The Role of Donations in General

The next issue, of course, is identifying when this twin failure occurs. The donative theory hypothesizes that the best evidence of twin failure is donations by more than a *de minimis* number of individuals to a given entity. Where neither the private markets nor the government supplies a good or service at an optimum level of production, high-demanders have no choice but to donate to the supplying entity to encourage more production. These donations, however, are virtually certain not to provide the entire needed production because of the free-riding problem: some high-demanders will not pay their "fair share" of the cost of increased production but rather free-ride on the donations of others. Higher education is a good example. Some have theorized that alumni donations to higher education are a form of delayed payment for one's education.[195] Private colleges and universities keep tuition artificially low to expand the number of students who can afford to attend, and then impress upon their alumni the "moral obligation" to make donations post-graduation in order to make up the difference between the true value of the education received and the amount actually charged as tuition.[196] Because this is only a moral obligation, however, and not a legally binding one, many graduates fail to donate or fail to donate at an appropriate level, free-riding on the donations of other alumni.[197] In these situations exemption comes to the rescue: by forgiving the tax liability otherwise due on income or property, the exemption becomes a form of "shadow subsidy" equal to the tax rate, permitting an entity to produce more based on its income and capital base than would be possible if the government took its tax cut.[198]

In theory, of course, it might be possible to provide a direct subsidy to various organizations equal in amount to the indirect subsidy provided by exemption. Such a system would require that government in effect measure each person's elasticity of demand for a particular good or service, assess taxes based upon that demand and then apportion tax dollars based upon that assessment. As a practical matter, of course, such a system would be impossible to administer. In absence of making people pay individually for, say, the right to breathe clean air, there is no way to measure an individual's marginal valuation of particular public or quasi-public goods. We could just ask people, of course, but the free-riding problem inherent in these goods would lead people to lie about their preferences. *See Nonprofit Sector, supra* note 190, at 53–54.

195. Hansmann I, *supra* note 6, at 860–61.
196. *Id.*
197. *See infra* text accompanying note 209 (noting that only about 28% of private university and college alumni donate to their institution post-graduation). The free-riding phenomenon also is consistent with Hansmann's observations regarding market behavior with respect to the performing arts and cultural organizations, another category of entities exempted under the educational rubric. Hansmann theorizes that donations to performing arts entities are a form of price discrimination, whereby patrons who can afford it pay more for the service than those who cannot. Since this price discrimination is *voluntary,* however, many patrons may not donate at all, or donate less than the value they place on the performance—the free-rider problem. Thus one can hypothesize that donations alone will not cover the entire demand for the service. Hansmann I, *supra* note 6, at 857–58.

Using donations as a proxy for twin failure is supported by economic research that tends to indicate that increases in government expenditures in a particular area may "crowd out" donations—that is, when government failure is reduced or reversed, donations fall. *E.g.,* Burten A. Abrams & Mark Schmitz, *The Crowding-Out Effect of Governmental Transfers on Private, Charitable Contributions, in* THE ECONOMICS OF NONPROFIT INSTITUTIONS 303 (Susan Rose-Ackerman ed., 1986). *But see* James Andreoni, *Giving and Impure Altruism: Applications to Charity and Ricardian Equivalence,* 97 J. POL. ECON. 1447 (1989) (finding less crowding-out effect than theory would suggest).

198. Hall & Colombo II, *supra* note 14, at 396. This is an extension of Burton

This, then, is the case for restricting exemption to donative entities. Exemption is warranted only when *both* the private market and direct government subsidies fail to produce goods and services desired by segments of the population at their optimum level—the "twin failure" phenomenon. Donations signal both the desire of a particular population segment to have increased production of a given good or service and that both private markets and direct government intervention are failing to produce the desired good or service at its optimum level.

c. Defining a Donation and The Donative Threshold

The remaining theoretical questions all revolve around the technical definition of a donative entity, a matter covered in great detail in a previous article.[199] To highlight some of the issues, Professor Hall and I concluded that donations should be measured against revenues, as opposed to expenditures, net income, or some other value because gross revenues provide the best measure of an entity's output capability. Since the donative theory presumes that twin failure affects optimum output, this appeared to be the best measure.[200] "Donations" would be defined as in current law (e.g., a transfer of money or property that resulted in no direct quid-pro-quo to the donor),[201] except that donated labor (not currently treated as a contribution under federal tax law) should be included in the measure of donations (as well as the measure of revenues), since such labor permits increased output as surely as cash or property donations.[202] The amount of donations would be measured net of fund-raising costs to discourage excess fund-raising designed merely to get an institution over the donative threshold.[203] We also concluded that government grants would *not* be included in the definition of donations, because such grants negate the government failure prong of the donative theory.[204] Finally, we concluded that gifts to capital or endowment (as opposed to gifts for current operations) should be counted when made, perhaps subject to some type of amortization

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Weisbrod's theory of the charitable *deduction*, which he theorizes is an indirect government "matching grant" that helps increase production of the particular good or service. NONPROFIT ECONOMY, *supra* note 190, at 30. *See* Paul R. McDaniel, *An Alternative to the Federal Income Tax Deduction in Support of Private Philanthropy, in* TAX IMPACTS ON PHILANTHROPY (Tax Inst. of Am. ed., 1972). *But see* Boris I. Bittker, *Charitable Contributions: Tax Deductions or Matching Grants,* 28 TAX L. REV. 37, 47 (1972) (criticizing "matching grant" theory).

199. Hall & Colombo, *supra* note 6. We also considered a number of other technical issues, such as how to deal with start-up entities that have no donative history, using a three-year average of donations and revenues to measure donative status in order to avoid a "bouncing" effect from yearly variations in donations, and others.

200. *Id.* at 1451 n.220.

201. *Id.* at 1458–59. Obviously, one needs to define exactly what a "donation" is, but this has already been done by a large body of administrative and case law under § 170 of the Code that addresses when an amount is truly a donation or is in fact a disguised payment for services rendered or goods sold. *See, e.g.,* Lombardo v. Commissioner, 50 T.C.M. (CCH) 1374 (1985) (no deduction for "contribution" made as part of a plea bargain agreement); Rev. Rul. 83–104, 1983–2 C.B. 46 (no deductible contribution for "donations" that really are disguised tuition payments to private schools). *See generally* BITTKER & LOKKEN, *supra* note 20, ¶ 35.1.3; James W. Colliton, *The Meaning of "Contribution or Gift" for Charitable Contribution Deduction Purposes,* 41 OHIO ST. L.J. 973 (1980).

202. Hall & Colombo, *supra* note 6, at 1459. The reason that donated labor is not treated as a deduction is that the value of such labor is not included in the taxpayer's gross income (as opposed to cash and property). *Id.* at 1459 n.243.

203. *Id.* at 1470–72.

204. *Id.* at 1460–61.

system for capital gifts (but not endowment gifts) to account for the fact that a capital gift is used up over time. The reasoning here was that an entity needs a capital base to output goods or services just as much as money for operations; in essence, the gift to capital or endowment is an aid to both current and future output. While one could attempt to include such donations in the donative base when they were "used up," we concluded that administering such a system would be too difficult.[205]

The major issue, however, concerns what level of donative support is necessary to invoke exemption. We previously have proposed based upon both historical evidence and current provisions of the Internal Revenue Code defining public charities that exemption be available only when one-third of an entity's gross receipts come from donations from a minimum number (seventeen) of donors.[206] Nevertheless, we also recognized that what the threshold should be is essentially a political judgment concerning when donations are high enough as a percentage of the entity's revenues to signify sufficient twin failure that granting the "shadow subsidy" of exemption is an appropriate response.[207] Specifically, we noted that the donative percentage might well be reduced for those institutions that suffered greater free-riding behavior than average, since the greater the amount of free-riding, the smaller the percentage of donations will be of revenues and the greater the gap between the entity's optimal production and its actual production capacity.[208]

In fact, educational institutions, particularly colleges and universities, are one example where free-riding is rampant. As noted above, alumni donations might be viewed as a sort of delayed payment by a graduate for the true cost of education.[209] Because this payment is a purely moral obligation, however, and the pressure to make it comes after one has garnered the benefit of one's degree, free-riding is likely to be high. Statistical evidence supports this view. During the period 1986-1988, only approximately 28.3% of the alumni of four-year private colleges and universities made contributions.[210] Thus over 70% of alumni of these institutions chose to free-ride on the donations of others. A lower donative percentage also guards against the possibility that entities receive exemption solely because they have rich alumni with money to throw around.[211]

In the educational area, therefore, one could argue for a donative threshold much lower than the one-third previously suggested on the basis of general historical evidence. I continue to believe, however, that 10% should be

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205. *Id.* at 1465–68.
206. *Id.* at 1450–65. The one-third of revenues donation threshold, the minimum number of donors (17) and other details of defining a donative entity were adapted from the systems of current federal tax law that distinguish between public charities and private foundations. I.R.C. §§ 170, 509 (1993); *see* Hall & Colombo, *supra* note 6, at 1446–50.
207. Hall & Colombo, *supra* note 6, at 1454.
208. *Id.* at 1456 n.233.
209. *Supra* text accompanying note 197.
210. COUNCIL FOR AID TO EDUC., VOLUNTARY SUPPORT OF EDUCATION 1987–1988, at 12, tbl. 10 (1989).
211. Again, statistics indicate there is some reason to worry about this issue: in 1988, alumni gifts in excess of $5000 constituted 34% of total alumni support for operations. *Id.* at 12. I note, however, that the richest institutions are not, in fact, those with the highest donative levels. *See* Appendix, tables 1, 3, 4 (in the research category, for example, Harvard ranks about midway—29th—on the list).

the absolute lowest limit. While 10% of an entity's revenues is still significant as a financial matter, many areas of tax law use 10% as the dividing line between a significant and insignificant amount.[212] Below this line, donations truly become relatively insignificant as a revenue source, and their signaling function becomes greatly attenuated. Thus a donative percentage in the range of 10-33% would appear appropriate; the effects of the two extreme thresholds are illustrated in the discussion below on the donative theory's effects on educational exemptions.

d. The Donative Theory's Theoretical Advantages

Regardless of the threshold one chooses, the donative theory has numerous advantages over competing theories of exemption. Because it is not tied to a direct quid-pro-quo for government, the donative theory answers the questions left open by the quid-pro-quo theory about why exemption exists for any number of activities that are not the government's responsibility. Since the theory uses donations as a predictor of twin failure, it also explains why for-profit firms (which do not receive donations) are treated differently even when they compete in the same markets. Compared to the community benefit theory, the donative theory offers an objective, administrable standard for exemption not built upon the IRS's (or state revenue department's) subjective determinations of what is good for society. It also provides the best measure of proportionality, matching the subsidy of exemption to the donative base needed to adequately serve demand for the exempt organization's goods or services.

The donative theory also answers the crucial question unexplained by Hansmann's capital subsidy theory, namely, why direct government intervention is not a superior means of addressing the capital problem (assuming it exists) in a particular sector. Because the donative theory presupposes the inability of the government to intervene due to the nature of the democratic system, direct intervention by government is simply not possible.

Finally, the donative theory places identifiable limits on the scope of Atkinson's altruism theory by looking to the repetitive conduct of independent third parties, donors, to judge whether, in fact, the entity is engaged in an altruistic enterprise. Thus rather than exempting all nonprofits because of an initial business decision to operate in nonprofit form, the donative theory requires annual reaffirmation that the exempt entity is engaged in an enterprise valued by a significant portion of the community.

More to the point at hand, the donative theory is vastly superior to the current system of limiting principles used by the IRS to circumscribe the educational exemption. A "commerciality" limit is no longer necessary, since the level of donations provide an objective test for determining when market and government failure has occurred. For-profit firms do not get donations;[213] thus

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212. Several tax provisions, for example, raise the issue whether "substantially all" the assets or revenue of an entity comes from one source or another. In these cases, the IRS generally has interpreted the phrase to mean at least 90%—or put positively, that more than 10% from the wrong source is significant. *E.g.*, Rev. Proc. 77-37, 1977-2 C.B. 568 (interpreting "substantially all the assets" in a reorganization context as 90% of the net assets); I.R.C. § 141(b) (1993) (defining a private activity bond as one in which "more than 10%" of the proceeds are used in private business activity); I.R.C. § 145 (1993) (using 90% as the cut-off for determining whether a tax-exempt bond is used entirely for hospital purposes).

213. Hall & Colombo, *supra* note 6, at 1435.

an entity receiving significant donations is providing some service valued by the community that its for-profit counterpart or government cannot or will not provide, and thus is deserving of the shadow subsidy of exemption withheld from commercial for-profit firms. In short, donations, rather than vague standards regarding how a good or service is delivered, become the dividing line between commercial and non-commercial enterprises. This same rationale is applicable to the "private benefit" limit: donations signal that an entity is providing some benefit to the community unavailable elsewhere, and hence the institution is not operating primarily for private benefit.[214]

The Service can also lay to rest the "full and fair exposition" or "methodology" tests for "propaganda" institutions. As noted above, the Treasury Department has never advanced a rationale for this limitation in any event. To the extent the concern behind the limitation was to avoid subsidizing the viewpoint of a single individual, the donative theory provides an answer by requiring a minimum breadth of donations to qualify. Moreover, to the extent a "propaganda" organization attracts significant donative support, its viewpoint must be one that the donors believe is underrepresented and hence is as deserving of subsidy as an underproduced good.[215]

Finally, the donative theory provides a firm theoretical foundation for the public policy limitation, which it would keep as an integral part of defining a donative entity. Since the donative theory posits that exemption is warranted in part due to a tacit cross-subsidization agreement among minority groups, a different result is called for when the majority specifically registers its dislike for a particular good or service. In such a case, no alternative exists for the majority to impose its will other than the withdrawal of the shadow subsidy of exemption. Thus when Congress expresses the will of the majority by enacting laws against segregated education, the majority must not be forced into a covert subsidization of segregated schools through exemption. This analysis brings a much sharper focus to the public policy doctrine: the public policy limitation should be invoked only when the legislature has enacted laws specifically prohibiting the conduct that would be subsidized by exemption, and not in cases of vague general policies or uneasiness about a group's activities. Under this analysis, for example, applying the public policy limitation to the *National Alliance* case described in Part III, above, probably would be incorrect: while the group's message of race war may be offensive to many, the strong protection of speech granted by the first amendment indicates that the public policy doctrine should not be invoked to deny exemption on the basis of an offensive message.[216] This would also be true of groups advocating feminist issues a la

214. The statutory *private inurement* limitation, however, would still be applicable, since the donative theory provides no immediate internal check on misuse of funds by organization managers. Over time, of course, an organization that misused its funds likely would find donations drop off as a result, *see id.* at 1398–1416 (describing how the "market in altruism" will cause donations to go up or down over time depending on whether contributors continue to believe the entity in question is providing a necessary good or service). Nevertheless, some immediate redress mechanism for misuse of funds by organization managers is probably good policy, and unlike the private benefit concept, the private inurement concept is more objective and far more administrable. *See supra* text accompanying notes 51–57.

215. This does not eliminate the restriction on legislative lobbying, however, which is not aimed at gaining wider general circulation for a viewpoint, but rather at negating government failure. *See generally* Hall & Colombo, *supra* note 6, at 1438–42.

216. The court in *National Alliance*, in fact, presumed that the entity's message in the case was protected by the first amendment, but simply did not qualify as "educational." National

Big Mama Rag or gay rights (an area in which the IRS previously indicated its disapproval).[217]

e. The Donative Theory's Effect on Educational Institutions

Still remaining is the practical question concerning what the donative theory in operation would do to the current scope of the educational exemption. Educational institutions are often cited by commentators as paradigm donative entities.[218] The statistical truth, however, is that educational institutions depend far less on donations than one might think, and for some of them the importance of donations is virtually nil. In this subsection, I break educational institutions into three parts (colleges and universities, primary and secondary schools, and "other" institutions currently exempt under the educational rubric, including performing arts) and examine the results of applying the donative theory to each both under the one-third threshold I originally proposed and under the absolute minimum 10% threshold discussed above. While the donative theory would make exemption judgments on an entity-specific basis, rather than by groups or by industry, examining group data will help establish the potential boundaries for exemption under the theory.

1) Colleges and Universities

The most comprehensive data regarding sources of funding for educational institutions exists in the realm of higher education, due to annual surveys conducted by the Council for Aid to Education. This data is summarized by institution in Tables 1, 3 and 4 in the Appendix for the years 1986-1988.[219] Table 5 illustrates that four-year private nonprofit institutions as a group derived only approximately 18.8% of their total education and general revenues from private donations,[220] as opposed to 51.9% from tuition, fees and other charges, and another 13.8% from government grants and contracts.[221]

Alliance v. United States, 710 F.2d 868, 875 (D.C. Cir. 1983) ("We have no doubt that publication of the National Alliance material is protected by the First Amendment from abridgment by law."). In a footnote, the court suggested that National Alliance might be denied exemption on the basis of its discriminatory policies, *id.* at 876 n.14; as yet, however, the United States has not passed laws banning discrimination in private organizations, and thus under the donative theory, the public policy limitation should not be applied to this case.

 Nevertheless, one might find that National Alliance's activities did in fact violate specific statutory prohibitions against inciting riots or the like. In that case, one could legitimately apply the public policy exception on the grounds identified in the text—for example, that government should not subsidize conduct deemed prohibited by the majority.

 217. *See supra* note 78.

 218. *E.g.,* Hansmann I, *supra* note 6, at 860 ("Institutions of higher education commonly depend heavily on voluntary private contributions ...."); Atkinson, *supra* note 6, at 539–40 (discussing donations to higher education institutions as a form of altruism); Bittker & Rahdert, *supra* note 6, at 333–35 (educational institutions are "public service" organizations that receive significant donations).

 219. See *infra* notes accompanying Appendix, tables 1–4, for an explanation of the sources and methodology used to construct these tables.

 220. Appendix, table 5.

 221. The tuition and government grant percentages are based on 1988 data only. SAMUEL F. BARBETT ET AL., STATE HIGHER EDUCATION PROFILES 17, tbl. 5 (4th ed. 1992). Barbett lists private donations as accounting for only approximately 12.7% of E&G revenues; the discrepancy between this number and that reported in the text is due to the fact that the Barbett report does not take into account donations to endowment or other capital funds, which should be included in the donative base for purposes of the donative theory of exemption. *See* Hall & Colombo, *supra* note 6, at 1465–68 (capital donations accounted for in donative threshold at

At first glance, therefore, it appears that *as a group* the private nonprofit college/university sector fails the one-third of support benchmark discussed above by a fairly wide margin, although such institutions would generally pass the minimum 10% mark. Closer inspection of available data, however, indicates several interesting points. First, donations played a much larger role for private liberal arts colleges than for either research institutions or private comprehensive institutions.[222] The overall percentage of revenues derived from donations for private liberal arts colleges was 27.12%, while the number for doctoral/research institutions was approximately 17.5% and for private general education colleges was approximately 15%.[223] These numbers appear to correspond generally to the economic basis for the donative theory. As noted below, research institutions depend far more heavily on government appropriations and grants for funding than do liberal arts institutions. As a result, research institutions suffer much less government failure than liberal arts or comprehensive institutions. The differences between the liberal arts colleges and the general comprehensive institutions can be accounted for by the simple fact that the liberal arts category contains the "big name" colleges such as Amherst, Bowdoin, Mount Holyoke, Radcliffe, Smith, Swarthmore, Vassar, Wellesley and Williams that have more established, and wealthier, alumni.[224] These institutions tend also to have much higher expenditures than their counterparts, and hence private market failure (in this case, the inability to charge tuition that would fully cover the educational costs) places a greater economic demand on these institutions than the comprehensive institutions.[225]

Second, as might be expected, donations as a percentage of revenues varied widely among institutions. As Table 1 in the Appendix illustrates, in the research category St. John's University reported donations over the three-year period 1986–1988 of about 2.2% of revenues, while Notre Dame reported donations equal to 47.4% of revenues and Cal Tech garnered donations of over 40% of revenues.[226] Nevertheless, virtually all the research institutions fell below a 33% donation threshold: of the 61 institutions in this group, only Notre Dame and Cal Tech received donations that accounted for 33% or more of education revenues.[227] On the other hand, all but nine of the surveyed institutions

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time made, but income from endowment excluded from donative calculation).

222. The categorization of colleges and universities in this study was based upon the Carnegie Foundation for the Advancement of Teaching's college classifications. COUNCIL FOR AID TO EDUC., *supra* note 210, at 5. The "Research/Doctoral" group in the study combined Carnegie classifications Research I, Research II, Doctoral Granting I and Doctoral Granting II. The "Comprehensive" group included four-year institutions offering bachelor's degrees, at least half of which were granted in professional or occupational fields. The "Liberal Arts" classification consisted primarily of undergraduate colleges that award more than half their degrees in the arts and sciences fields. *Id.* at 15. A complete listing of the surveyed institutions is included at *id.* at 16–58. *See also* Appendix, tables 1, 3, 4 and accompanying notes.

223. Appendix, table 5.

224. Appendix, table 4; *see also* Roger L. Geiger, *Finance and Function: Voluntary Support and Diversity in American Private Higher Education, in* PRIVATE EDUCATION: STUDIES IN CHOICE AND PUBLIC POLICY 214, 226–29 (Daniel C. Levy ed., 1986).

225. In 1988, for example, these colleges accounted for total E&G expenditures of $396 million, 9% of the total expenditures of the liberal arts group, even though they are only 3% of the number of institutions in the sample. COUNCIL FOR AID TO EDUC., *supra* note 210, at 35–48. Their overall donative percentage for this year, not including donated labor or adjustments for government grants, was 32% (donations of $126.5 million and estimated revenues of $396 million). *Id.*

226. Appendix, table 1.

227. *Id.*

reported donations in excess of 10% of revenues, indicating that this donative threshold better fits with the historical trend of exempting private colleges and universities. Thus while the absolute dollar amount of donations to the top research universities is high—the "top 20" garnered private support of almost $2 *billion* in 1988[228]—donations tend to be only moderately important as an overall source of revenue for major research universities, and virtually insignificant for a few.

Similar institutional variations occurred in the other categories: in the comprehensive category, donations made up approximately 80% of Berea College's revenues, but only .8% of the revenues of St. Thomas Aquinas College and only 2.6% of Fairleigh Dickinson University.[229] In this category, comprising 176 institutions, only 13 reported donations above 33% of revenues, while 52 reported donations below 10% of revenues for the period. In the liberal arts category, donations accounted for 97% of the revenues of Catawba College, but only 2.5% of the revenues of Gallaudet University.[230] Of the 301 institutions in this category, 98 reported donations in excess of 33% of revenues, while only 18 reported donations below 10% of revenues.

One anomaly in these donative percentages, however, is that while the revenue numbers include government grants, the donation numbers do not (i.e., the denominator of the donative fraction includes government grants in revenues, but the numerator—donations—does not). The theoretical reason for not including government grants as "donations" is that direct government support negates the government failure prong of the twin failure that underlies the donative theory, and thus such grants do not signal any need for the additional matching subsidy of exemption.

On the other hand, including government grants in the revenue base against which donations are measured results in a type of penalty to a grant recipient: the grant is not part of the donation number, but it increases revenues and thus decreases the donative percentage (donations divided by revenues). Another approach would be to exclude government grants from *both* the numerator and denominator of the donative fraction. As a theoretical matter, such exclusion is justified by the fact that an entity supported by government grants should be exempt in any event because the government should not tax itself. Thus, for example, an entity with $1,000,000 in revenues, $900,000 of which comes from government grants and $100,000 of which comes from donations, ought to be exempt, not because it is overwhelmingly donative but under a combination of the donative theory and the notion that the government should not tax its own grants.[231] Under this hypothesis, eliminating government grants from the revenue base results in donations constituting 23.57% of remaining revenues for all private four-year institutions, still below the one-

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228. COUNCIL FOR AID TO EDUC., *supra* note 210, at 11.
229. Appendix, table 3.
230. Appendix, table 4. One might wonder about a theory of exemption that potentially would exclude Gallaudet, a renowned school for the deaf, from exemption. While I do not have access to Gallaudet's financial records, I can hypothesize that Gallaudet receives far greater *direct* government support from various programs designed to educate the handicapped than would be true of the average liberal arts college. As a result, Gallaudet probably suffers less from government failure than other institutions do, and this is reflected in the lack of donative support (e.g., direct government aid displaces the need for donative support).
231. *See* Hall & Colombo, *supra* note 6, at 1460 n.249.

third threshold, but closer than the 18.8% of all revenues.[232] Once again the results vary widely in importance depending on type of institution. Excluding government grants from the revenue base for research/doctoral institutions raises the donative percentage to 24.12% from 17.52%; because of their lesser dependence on government grants, however, the donative percentage for comprehensive and liberal arts institutions rises only slightly, to 16.3% (from 15%) and 29.68% (from 27.12%), respectively. Assessing the effect of eliminating government grants and direct aid on individual institutions is more problematic because the available data does not include actual government grant numbers for each institution. Nevertheless, one can get an estimate of the effect of eliminating government grants on the individual institutions by assuming that each institution gets a percentage of its revenues from government grants equal to the average for the group;[233] these results are tabulated for doctoral/research institutions in Table 2.[234] This tabulation shows that under this average assumption, the number of research institutions whose donative percentage exceeds one-third of revenues rises to 12 from 2, and all but six would meet the 10% threshold. The number of comprehensive institutions meeting the one-third threshold under this scenario rises to 14, while the number below 10% drops slightly to 48. The number of liberal arts institutions above the one-third threshold rises to 123, while only 16 fall below a 10% threshold.

Finally, the numbers discussed so far do not include the value of donated labor. Because donated labor serves as just as much an indicator of twin failure as actual cash or property donations, the donative percentage of an institution should be measured taking donated labor into account.[235] A recent report on volunteering indicated that in 1987, volunteer labor in the educational sector was worth in excess of $4.6 billion.[236] Unfortunately, no data exists on exactly how much labor is donated to each subcategory of educational institutions.[237] While it is likely that *some* labor is donated to colleges and universities other than for fund-raising,[238] the amount of such donated labor likely is small.

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232. Appendix, table 5.
233. Note that because *individual* school percentages are calculated in the tables using an *average* percentage of government grants, the numbers for individual schools in these tables might be highly inaccurate. In the liberal arts category, for example, I would expect that Gallaudet University receives a much higher percentage of its revenues in the form of direct government aid than average, and hence its donative percentage excluding this government aid might well be higher than the table indicates.
234. Because of the slight effects of this calculation on comprehensive and research institutions, I did not construct tables for the institutions in these categories, although I did determine how this calculation would affect the number of institutions above the 33% threshold and below the 10% threshold in these categories.
235. *See* Hall & Colombo, *supra* note 6, at 1459.
236. *See* VIRGINIA A. HODGKINSON & MURRAY S. WEITZMAN, DIMENSIONS OF THE INDEPENDENT SECTOR: A STATISTICAL PROFILE 169, tbl. 7.6 (1989). The estimate in the text was derived by taking the full-time equivalent employees reported by Hodgkinson and Weitzman for the educational sector, multiplying this number by 1700 hours per volunteer, and multiplying this result by $10.06, the hourly wage figure used by Hodgkinson and Weitzman to value donated labor. I disregarded the value of labor donated for fundraising purposes. *See* Hall & Colombo, *supra* note 6, at 1470–72 (fundraising costs should be deducted from gross donations in arriving at the donative percentage).
237. *See* VIRGINIA A. HODGKINSON & MURRAY S. WEITZMAN, GIVING AND VOLUNTEERING IN THE UNITED STATES: FINDINGS FROM A NATIONAL SURVEY 238 (1990) (poll question number 13).
238. Labor donated for fund-raising purposes should be ignored, since fund-raising costs should be deducted from gross donations in order to avoid an incentive for an entity to spend

Unlike primary and secondary schools, where parents often donate time for PTA meetings, help in the classroom, supervising field trips and the like,[239] the opportunities for donating labor at the higher education level are limited. Moreover, alumni, the major source of donations for higher education, often are geographically dispersed, making any significant labor donation impractical. Hence it is unlikely that donated labor would alter significantly the donative percentages at the higher education level.

2) Private Elementary/Secondary Schools

Data regarding donations as a percentage of revenues for private elementary and secondary schools are more difficult to come by. In general, these schools break into two broad categories: religious-affiliated schools, such as the Catholic school system, and nonsectarian schools. As a group, religious-affiliated schools appear to surpass the suggested donative thresholds, largely because of the support they receive from their sponsoring church.[240] A 1988 report on the financing of Catholic elementary schools indicated that such schools receive approximately 39.6% of their revenues as a subsidy from general parish revenues, another 1.9% from diocesan subsidies, and another 7.5% from private fundraising for an overall donative percentage of 49%.[241] Earlier surveys of Lutheran schools reported an even higher percentage—62.2%—of support from the church.[242] Moreover, as a group these schools tend to rely on tuition and fees for less than half their revenues.[243] Thus by any of the suggested thresholds, religious schools as a group pass the donative test, although rare individual schools might fail.

While not as dependent on donations as religious schools, nonsectarian private schools still receive significant donations, and as a group rank on par with private research universities in total donative support as a percentage of education revenues. The 1985-1988 surveys on voluntary support of education by the Council for Aid to Education reported that surveyed independent elementary and secondary schools had total donations in excess of $1.361 million for the two-year period, amounting to approximately 26% of total estimated education and general revenues of such institutions. This percentage is more than enough to pass a reduced donative threshold of 10%, and close to the

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disproportionate amounts on fund raising in order to just make the donative threshold. *See supra* text accompanying note 201.

239. I have no source for this statement other than the experience of being a parent to a first-grader in a parochial school. I can say with some confidence, however, that my percentage of donated labor has increased dramatically in the past year!

240. In general, donations from institutions that are themselves "donative" should be counted in the donation percentage. Hall & Colombo, *supra* note 6, at 1465. Churches tend to be the most "donative" of any institutions. Burton Weisbrod, for example, has estimated that religious institutions receive over 70% of their revenues in the form of donations. Burton Weisbrod, *Private Goods, Collective Goods: The Role of the Nonprofit Sector, in* THE ECONOMICS OF NONPROPRIETARY ORGANIZATIONS 139, 151-60 (Kenneth W. Clarkson & Donald L. Martin eds., 1980). Thus the support received by religious-affiliated schools from their sponsoring churches has been included in the estimate of donative support in the text.

241. FRANK W. BREDEWEG, UNITED STATES CATHOLIC ELEMENTARY SCHOOLS AND THEIR FINANCES 1988, at 10 (1988).

242. DANIEL J. SULLIVAN, PUBLIC AID TO NONPUBLIC SCHOOLS 24 (1974) (summarizing in a table statistics taken from 1972-1973 surveys of Lutheran schools).

243. BREDEWEG, *supra* note 241, at 10, tbl. 6 (showing tuition and fees accounting for 45.3% of total revenues for Catholic elementary schools); SULLIVAN, *supra* note 242, at 24 (tuition and fees account for 28.3% of Lutheran school revenues).

one-third threshold.[244] Moreover, as was the case with private universities, this donative percentage does not include the value of donated labor. Unlike private universities, however, the value of donated labor at the primary and secondary school level is likely to be quite significant. For example, if one apportions donated labor value to these schools in proportion to their cash donation receipts, the donative percentage would rise to 41%, in excess of even the one-third threshold.[245]

3) Other Educational Institutions

Overall data on donations as a percentage of revenue for all the other kinds of institutions exempt under federal law as "educational" is difficult to come by. Nevertheless, the available data tends to confirm the donative theory as producing results that are consistent with both economic theory and "gut instinct" regarding what should be exempt. For example, according to one estimate, private gifts and donations make up some 63% of the total revenues of nonprofit arts and cultural organizations such as museums, symphony orchestras, opera companies and the like, well in excess of any of the suggested donative thresholds.[246] These results track the economic notion that donative entities operate at the conjunction of private market and government failure: the local symphony could not operate on a purely for-profit basis, and the government (thankfully) doesn't run many orchestras.[247]

One can only speculate with respect to other organizations, since no

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244. COUNCIL FOR AID TO EDUC., VOLUNTARY SUPPORT OF EDUCATION 1986–1987, at 86 (1988); COUNCIL FOR AID TO EDUC., VOLUNTARY SUPPORT OF EDUCATION 1987–1988, at 88 (1989). As with the tables in the Appendix, the revenue numbers were estimated by taking the reported education and general expenditures for the period (amounting to $5.221 billion) and multiplying this figure by a factor of 1.02. This factor was derived from data reported by the National Association of Independent Schools, showing that in 1988, independent primary and secondary schools spent about 98% of their operating revenues. NATIONAL ASS'N OF INDEP. SCH., NAIS 1989–1990, at 37, tbl. 26 (1990).

245.   To arrive at this number, I took the estimated number of full-time equivalents for the educational sector as a whole as reported in HODGKINSON & WEITZMAN, supra note 236, at 169, tbl. 7.6, multiplied this number by 1700 hours per full time equivalent, and then multiplied this result by $10.06, the wage rate used by Hodgkinson and Weitzman to value labor. I disregarded labor value attributable to religious institutions or to fundraising. The resulting number was $4.6 billion (obtained by multiplying the 271,000 number in column five of table 7.6 by 1700 and then by $10.06). Since this was a 1987 figure, the midpoint of my three-year data base, I multiplied the 4.6 billion number by 3 to obtain a donated labor estimate for the three-year period under review. I then apportioned this number to the private primary/secondary school sector based upon the ratio of cash donations to these institutions to cash donations to the educational sector as a whole as reported by Hodgkinson and Weitzman. Id. at tbl. 8.1.

This methodology obviously assumes that donated labor will "track" cash and property donations. There is some indirect evidence that supports this proposition. Data on giving and volunteering habits, for example, show that those people who give more cash or property also donate more labor. Id. at 19, 37. One would assume that those inclined to donate their time would do so to those institutions to which they give money. Also, the amount of donated labor to each subsector of nonprofit activity appears to roughly correlate to donations. In 1987, for example, religious institutions accounted for roughly 49% of total donations to private nonprofit organizations and also accounted for 40% of the total donated labor. Education accounted for 9% of total donations and 9% of the donated labor; arts and cultural organizations accounted for 7% of total donations and 5% of total donated labor. Id. at 169 & tbl. 7.6, 177 & tbl. 8.1.

246.   SALAMON, supra note 1, at 93–94.

247.   This is not to minimize the government's role in providing direct government subsidies for cultural organizations, such as the National Endowment for the Arts.

systematic data regarding their donative status is available.[248] Donations, however, appeared to play a major part in one of the key cases on propaganda institutions: the D.C. Circuit's reversal of the IRS's denial of exemption in *Big Mama Rag*. There the court noted that the organization in question "has a predominantly volunteer staff and ... is dependent on contributions, grants and funds raised by benefits for over fifty percent of its income."[249] One would expect, in fact, that organizations representing various "causes" would rely to a significant extent on donations and donated labor to produce their "product." Exempting these organizations is fully consistent with the twin failure theory: because these groups are generally "minorities" in the broad sense of the term, direct government aid is unlikely, and the overall product (representation of the group's view) is not one that can participate in a private market.

On the other hand, one also would expect that organizations offering update seminars to bankers and CLE programs to lawyers rely little, if at all, on donations, being primarily fee-for-service entities.[250] As a result, such entities probably would not be exempt under the donative theory—without, I might add, any apparent disaster to society, inasmuch as lawyers and bankers certainly do not need a government subsidy to stay current in their fields.

4) Summary

This section of this Article indicates that the donative theory is broadly consistent with the historical scope of the educational exemption, although the theory has a better match with historical exemption of colleges and universities using a 10% donative threshold. At this threshold, virtually all private colleges, universities, primary and secondary schools remain exempt, along with museums and cultural organizations. The few traditional educational institutions that would fail exemption under the donative theory simply evidence no market failure that would justify the shadow subsidy of exemption: the lack of donations indicate that their financial needs are being met either by the private market (i.e., charging tuition or fees or both) or by government intervention. Moreover, although data on "other" educational institutions is virtually nonexistent, the donative theory likely would "fence out" those organizations that intuitively are particularly undeserving—specifically, the professional seminar organizations and other fee-for-service organizations aimed at limited audiences with the ability to purchase their product.

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248.   While IRS Form 990 collects data on contributions and revenues, the IRS does not code these forms for the type of institution reporting. Thus while IRS 990 data can be used to get an overview of the finances of nonprofit organizations, categorical information does not exist. Telephone interview with Ms. Cecilia Hilgert, IRS Statistics of Income Office, July 21, 1993. The Independent Sector, however, currently is at work on a project to code Form 990 data by type of institution. Telephone interview with Mr. Steve Noga, The Independent Sector, July 21, 1993. The results of this work should be available in about a year, at which point I can write another article about whether my speculations in the next two paragraphs are correct.

249.   Big Mama Rag, Inc. v. United States, 631 F.2d 1030, 1032 (D.C. Cir. 1980).

250.   For example, as I write this I am staring at a mailing by the Practicing Law Institute, "a nonprofit organization," advertising seminars on tax strategies for corporate acquisitions, dispositions, spin-offs and corporate financing techniques. These seminars are to be held in the Waldorf–Astoria Hotel in New York City and the Bel Age Hotel in Los Angeles. One can participate for only $950 (not including, of course, hotel accommodations). I do not see advertised in this mailing anything like a subsidized dues program for corporate tax lawyers too poor to afford the fee. Hmmm.

V. CONCLUSION

This Article began with a question, why is Harvard tax-exempt? I believe that the donative theory provides the best answer to that question: To the extent Harvard can justify exemption, it is because of its reliance on private donations, which in turn indicate that Harvard produces some product or service valued by a significant portion of society but undersupplied by the private market and undersupported by government. Admittedly, Harvard and many of its research compatriots do not present the strongest case statistically for exemption under the donative theory. Given the fact that both government grants and tuition charges play far larger roles in their financing than donations, I would have little trouble sleeping if exemption were denied to Harvard and friends. Other universities, particularly in the liberal arts sector, private elementary schools, arts and cultural organizations demonstrate much worse pictures of combined private market and government failure, and thus present far stronger cases for exemption in terms of donations as a percentage of revenues. On the other hand, there are cases far weaker than Harvard's, too, and given my own position as an employee of a research-oriented institution, I am somewhat sympathetic to the inevitable "margin of excellence" arguments that will be used to explain why donations are in fact more important to these institutions than sheer percentages would indicate. Nevertheless, donations are such a small part of funding for some institutions that exemption should be denied on the grounds that these institutions do not face the problems of twin failure in their particular markets.

Whatever donative threshold is chosen, however, the donative theory provides an administrable, objective standard for exemption sorely lacking either in the law as applied today by the IRS and state tax agencies, or in other theories of exemption. With it, we can supplant litigation over "commerciality," "private benefit," "propaganda," and "community benefit" with a standard dependent on the objective conduct of the parties most interested in where tax dollars go, the taxpaying public. Without it, we will be condemned to an ever-expanding definition of what constitutes a charitable institution, reined in only by the subjective notions of "goodness" of the Internal Revenue Service and courts. Surely taxpayers, and tax policy, deserve better.

APPENDIX

TABLE 1

Donations as a Percentage of Revenues 1986–1988

Doctoral/Research Institutions

(in thousands)[251]

Institution	Total Donations	Total Revenues	Donative %
Notre Dame U.	138,894	292,801	47.44%
Cal. Inst. Tech.	183,386	456,290	40.19%
Miss. College	12,228	41,326	29.59%
Baylor U.	68,206	248,671	27.43%
Texas Christian U.	48,042	176,303	27.25%
Princeton U.	176,089	659,310	26.71%
Stanford U.	559,712	2,107,737	26.56%
Andrews U.	22,166	83,774	26.46%
Washington U.	307,182	1,165,831	26.35%
Cornell U.	405,963	1,560,844	26.01%
Brown U.	116,133	461,826	25.15%
Rockefeller U.	61,435	245,563	25.02%
Brandeis U.	68,103	275,394	24.73%
Yale U.	351,463	1,431,077	24.56%
Loyola U. Chicago	88,735	362,862	24.45%
Pepperdine U.	56,290	233,260	24.13%
Claremont U.	15,198	64,103	23.71%
Duke U.	223,544	946,627	23.61%
Rice U.	60,799	271,077	22.43%
Lehigh U.	67,589	319,014	21.19%

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251. The basic data for this table was taken from COUNCIL FOR AID TO EDUC., VOLUNTARY SUPPORT OF EDUCATION 1985–1986, 1986–1987, and 1987–1988 (1987, 1988 and 1989, respectively). This annual survey of voluntary support of education includes both donations to current operating revenues and to capital and endowment, and annual educational and general [E&G] expenditures for each institution. I omitted any institution lacking 1988 data and any institution for which there were not at least two years' of donation reports (this was done as a check against an aberrational single years' number). See Hall & Colombo, *supra* note 6, at 1469 (donative percentage should be based on a three-year average of donations and revenues to avoid yearly variations in status). The values listed for Emory University and Harvard University in these tables are based on 1988 data only; although each of these universities reported their donation amounts each year, they failed to report E&G expenditures in the 1986 and 1987 surveys.

The Council for Aid to Education surveys do not contain E&G revenue numbers. The E&G revenue numbers in the table were estimated by multiplying the E&G expenditure numbers in the report by 1.02 for institutions with medical schools and 1.03 for institutions without medical schools. These multiplication factors are based upon analysis of financial data contained in annual surveys conducted for the National Center for Education Statistics, which showed that in 1988, E&G expenditures for doctoral institutions with medical schools averaged 98% of revenues, and E&G expenditures for doctoral institutions without medical schools averaged 97% of E&G revenues. BARBETT ET AL., *supra* note 221, at 7, tbl. T–5.

TABLE 1, continued

Institution	Total Donations	Total Revenues	Donative %
Illinois Inst. Tech	34,595	175,468	19.72%
Miami, U. of	158,257	803,355	19.70%
Dartmouth Coll.	87,314	456,843	19.11%
Emory U.[252]	48,121	252,453	19.06%
Chicago, U. of	197,726	1,037,383	19.06%
Carnegie Mellon U.	101,651	544,791	18.66%
Southern Meth. U.	63,043	338,930	18.60%
Rensselaer Polytech.	62,619	341,941	18.31%
Harvard U.[253]	155,104	882,824	17.57%
San Francisco, U. of	26,991	153,752	17.55%
MIT	269,814	1,537,544	17.55%
New Sch. Soc. Res.	32,440	188,412	17.22%
Southern Cal., U. of	245,264	1,503,514	16.31%
Case Western Res. U.	94,470	581,331	16.25%
Columbia U.	292,864	1,893,245	15.47%
Drake U.	17,454	115,873	15.06%
Pennsylvania, U. of	272,903	1,855,625	14.71%
Tulane U.	69,424	473,918	14.65%
Northwestern U.	172,602	1,187,860	14.53%
Boston Coll.	38,092	265,012	14.37%
Tufts U.	70,042	498,957	14.04%
Marquette U.	35,647	258,754	13.78%
Vanderbilt U.	84,201	664,353	12.67%
Tulsa, U. of	18,310	150,532	12.16%
Denver, U. of	26,547	219,007	12.12%
St. Louis U.	44,450	380,926	11.67%
Johns Hopkins U.	169,376	1,478,433	11.46%
Rochester, U of	87,613	783,362	11.18%
Syracuse U.	63,512	610,770	10.40%
Duquesne U.	13,086	126,455	10.35%
Georgetown U.	59,577	591,433	10.07%
NYU	170,921	1,702,106	10.04%
Clark U.	10,506	106,131	9.90%
Boston U.	89,106	1,162,860	7.66%
George Wash. U.	46,651	630,554	7.40%
Hofstra	10,421	179,010	5.82%
Fla. Inst. Tech.	5,286	95,312	5.55%
Northeastern U.	27,168	607,447	4.47%
Howard U.	21,005	649,415	3.23%
Adelphi U.	3,512	128,394	2.74%
St. John's U.	6,310	290,604	2.17%

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252.   1988 data only. *See supra* note 251.
253.   1988 data only. *See supra* note 251.

TABLE 2

Donations as a Percentage of Education and General Revenues 1986-88

Excluding Government Appropriations and Grants

Doctoral/Research Institutions

(in thousands)[254]

Institution	Total Donations	Total Revenues	Revenues Excluding Government Grants	Medical School ?	Donative % Excluding Government Grants
Notre Dame U.	138,894	292,801	239,926	no	57.89%
Cal. Inst. Tech.	183,386	456,290	373,892	no	49.05%
Baylor U.	68,206	248,671	170,657	yes	39.97%
Stanford U.	559,712	2,107,737	1,446,486	yes	38.69%
Washington U.	307,182	1,165,831	800,080	yes	38.39%
Cornell U.	405,963	1,560,844	1,071,167	yes	37.90%
Brown U.	116,133	461,826	316,940	yes	36.64%
Miss. College	12,228	41,326	33,863	no	36.11%
Yale U.	351,463	1,431,077	982,112	yes	35.79%
Loyola U. Chi.	88,735	362,862	249,023	yes	35.63%
Duke U.	223,544	946,627	649,646	yes	34.41%
Texas Christian U.	48,042	176,303	144,466	no	33.25%
Princeton U.	176,089	659,310	540,250	no	32.59%
Andrews U.	22,166	83,774	68,646	no	32.29%
Rockefeller U.	61,435	245,563	201,219	no	30.53%
Brandeis U.	68,103	275,394	225,663	no	30.18%
Pepperdine U.	56,290	233,260	191,137	no	29.45%
Claremont U.	15,198	64,103	52,527	no	28.93%
Miami, U. of	158,257	803,355	551,322	yes	28.70%
Dartmouth Coll.	87,314	456,843	313,520	yes	27.85%
Emory U.[255]	48,121	252,453	173,252	yes	27.78%
Chicago, U. of	197,726	1,037,383	711,929	yes	27.77%
Rice U.	60,799	271,077	222,126	no	27.37%
Lehigh U.	67,589	319,014	261,405	no	25.86%
Harvard U.[256]	155,104	882,824	605,860	yes	25.60%
Illinois Inst. Tech.	34,595	175,468	143,781	no	24.06%
Southern Cal., U. of	245,264	1,503,514	1,031,823	yes	23.77%

254.   The source and methodology for this table is the same as in table 1, *supra* note 251. The "Revenues Excluding Government Grants" column was derived by subtracting from Total Revenues the estimated amount of revenues derived from governmental grants and direct appropriations. This factor was 30% in 1988 for research institutions with medical schools, and 15.7% for research institutions without medical schools. BARBETT ET AL., *supra* note 221, at 18, tbl. 5. The donation percentage figures were calculated by dividing the total donations reported in the Council for Aid to Education studies by the adjusted revenues. Note that because the "Revenues Excluding Government Grants" column is an estimate based on the *average* percentage of revenues from government grants, the numbers in the table are only approximations, and individual numbers may well be considerably different from reality for institutions whose *actual* government grants and aid are higher-than-average or lower-than-average (this situation might well occur, for example, at Cal Tech, MIT and other high-tech oriented programs where government research grants might be well above average).

255.   1988 data only. *See supra* note 251.

256.   1988 data only. *See supra* note 251.

TABLE 2, continued

Institution	Total Donations	Total Revenues	Revenues Excluding Government Grants	Medical School ?	Donative % Excluding Government Grants
Case West. Res. U.	94,470	581,331	398,952	yes	23.68%
Carnegie Mellon U.	101,651	544,791	446,411	no	22.77%
Southern Meth. U.	63,043	338,930	277,725	no	22.70%
Rensselaer Polytech.	62,619	341,941	280,193	no	22.35%
Pennsylvania, U. of	272,903	1,855,625	1,273,468	yes	21.43%
MIT	269,814	1,537,544	1,259,890	no	21.42%
San Francisco, U. of	26,991	153,752	125,987	no	21.42%
Tulane U.	69,424	473,918	325,238	yes	21.35%
Northwestern U.	172,602	1,187,860	815,198	yes	21.17%
New Sch. Soc. Res.	32,440	188,412	154,388	no	21.01%
Tufts U.	70,042	498,957	342,422	yes	20.45%
Marquette U.	35,647	258,754	177,576	yes	20.07%
Columbia U.	292,864	1,893,245	1,551,358	no	18.88%
Vanderbilt U.	84,201	664,353	455,928	yes	18.47%
Drake U.	17,454	115,873	94,948	no	18.38%
Boston Coll.	38,092	265,012	217,155	no	17.54%
St. Louis U.	44,450	380,926	261,420	yes	17.00%
Johns Hopkins U.	169,376	1,478,433	1,014,611	yes	16.69%
Rochester, U. of	87,613	783,362	537,601	yes	16.30%
Tulsa, U. of	18,310	150,532	123,349	no	14.84%
Denver, U. of	26,547	219,007	179,458	no	14.79%
Georgetown U.	59,577	591,433	405,885	yes	14.68%
NYU	170,921	1,702,106	1,168,112	yes	14.63%
Syracuse U.	63,512	610,770	500,476	no	12.69%
Duquesne U.	13,086	126,455	103,620	no	12.63%
Clark U.	10,506	106,131	86,966	no	12.08%
Boston U.	89,106	1,162,860	798,041	yes	11.17%
George Wash. U.	46,651	630,554	432,733	yes	10.78%
Hofstra U.	10,421	179,010	146,684	no	7.10%
Fla. Inst. Tech.	5,286	95,312	78,100	no	6.77%
Northeastern U.	27,168	607,447	497,752	no	5.46%
Howard U.	21,005	649,415	445,677	yes	4.71%
Adelphi U.	3,512	128,394	105,208	no	3.34%
St. John's U.	6,310	290,604	238,126	no	2.65%

TABLE 3

Donations as a Percentage of Revenues 1986-1988

Comprehensive Institutions

(in thousands)[257]

Institution	Total Donations	Total Revenues	Donative %
Berea Col.	37,007	46,096	80.28%
St. Augustine's Col.	14,137	21,362	66.18%
Ouachita Baptist U.	14,123	22,425	62.98%
Hardin-Simmons U.	19,893	34,098	58.34%
Samford U.	31,541	54,467	57.91%
Oklahoma Christian Col.	13,222	26,079	50.70%
Loyola-Marymount U.	69,487	142,651	48.71%
Drury Col.	13,808	28,886	47.80%
Carson Newman Col.	13,084	30,905	42.34%
Portland, U. of	21,170	51,628	41.01%
Oklahoma City U.	12,240	34,708	35.27%
Stetson U.	22,853	65,495	34.89%
Jacksonville U.	12,683	36,958	34.32%
Richmond, U. of	31,804	102,091	31.15%
Rollins Col.	20,029	65,434	30.61%
Chapman Col.	23,078	76,382	30.21%
Concordia Col. Moorehead	16,711	55,422	30.15%
Abilene Christian U.	23,415	78,910	29.67%
Christian Bros. Col.	7,560	25,548	29.59%
Campbell U.	12,315	42,011	29.31%
So. Seventh Day Adv. Col.	7,537	26,025	28.96%
Messiah Col.	12,865	44,749	28.75%
Illinois Wesleyan U.	11,026	38,366	28.74%
Illinois Benedictine Col.	10,503	37,878	27.73%
American U. in Cairo	8,467	30,687	27.59%
Cedarville Col.	8,002	29,314	27.30%
California Lutheran U.	11,445	44,678	25.62%
Indianapolis, U. of	9,591	37,560	25.54%
Bethel Col. & Theol. Sem.	11,767	46,766	25.16%
Harding U.	13,514	53,841	25.10%
Meredith Col.	7,585	31,477	24.10%
Gonzaga U.	19,857	82,459	24.08%
Wake Forest U.	110,388	461,416	23.92%
Trinity U.	16,671	69,817	23.88%
Anderson U.	11,578	48,643	23.80%
Xavier U. of Louisiana	11,854	50,731	23.37%
Susquehanna U.	9,931	42,668	23.28%
Hood Col.	9,380	40,927	22.92%
Baptist Col. at Charleston	5,921	26,057	22.72%
Whittier Col.	11,586	51,062	22.69%
Millikin U.	9,708	43,735	22.20%

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257.   The sources and methodology for this table are the same as in Table 1. *See supra* note 251.

TABLE 3, continued

Institution	Total Donations	Total Revenues	Donative %
Ottawa U.	4,147	19,006	21.82%
William Jewell Col.	8,459	38,889	21.75%
Southwest Baptist U.	7,276	33,610	21.65%
Garder-Webb Col.	5,040	23,403	21.54%
John Carroll U.	13,250	61,586	21.51%
Walla Walla Col.	8,690	40,852	21.27%
St. Mary's Col. of Calif.	13,024	61,697	21.11%
Valparaiso U.	18,574	91,355	20.33%
Clark Col.	9,080	44,871	20.24%
Bethune Cookman Col.	10,617	52,642	20.17%
Regis Col. CO	8,168	42,187	19.36%
Evansville, U. of	13,517	70,127	19.28%
Point Loma Nazarene Col.	8,492	44,164	19.23%
Augsburg Col.	8,461	44,327	19.09%
Bellarmine Col.	3,819	20,089	19.01%
Linfield Col.	8,555	45,094	18.97%
Mt. St. Mary's Col.	6,713	35,412	18.96%
Brenau Col.	4,446	23,859	18.63%
Santa Clara U.	33,073	177,929	18.59%
Seattle U.	15,288	83,491	18.31%
Our Lady Holy Cross Col.	1,674	9,157	18.28%
Baldwin Wallace Col.	9,520	52,716	18.06%
North Central Col.	7,324	41,581	17.61%
West Va. Wesleyan Col.	4,093	23,352	17.53%
La Roche Col.	2,895	16,584	17.46%
Monmouth Col.	10,896	65,047	16.75%
Buena Vista Col.	5,894	35,445	16.63%
St. Norbert Col.	7,317	44,336	16.50%
Augustana Col. SD	6,953	42,299	16.44%
Avila Col.	2,514	15,455	16.27%
Capital U.	9,768	60,572	16.13%
Canisius Col.	8,485	53,132	15.97%
Carroll Col. MT	3,099	19,502	15.89%
Bradely U.	17,955	113,158	15.87%
La Salle U.	13,773	87,474	15.75%
St. Mary's Col. IN	8,035	51,703	15.54%
Marymount U.	6,301	40,699	15.48%
Elon Col.	7,125	46,526	15.31%
Azusa Pacific U.	6,998	46,212	15.14%
St. Thomas, Col. of	23,857	159,110	14.99%
Otterbein Col.	6,839	45,617	14.99%
Xavier U.	14,678	98,513	14.90%
Ashland Col.	8,236	55,896	14.73%
Lindenwood Col.	2,127	14,466	14.70%
Siena Col.	6,374	45,293	14.07%
Ferrum Col.	4,041	28,899	13.98%
Fairfield U.	13,242	97,259	13.62%
Seattle Pacific U.	9,279	68,503	13.55%
St. Catherine, Col. of	7,181	53,664	13.38%
Assumption Col.	5,089	38,280	13.29%
Our Lady of the Lake U.	4,049	30,909	13.10%

TABLE 3, continued

Institution	Total Donations	Total Revenues	Donative %
Stonehill Col.	5,388	41,305	13.04%
Whitworth Col.	4,682	36,294	12.90%
Butler U.	9,124	71,056	12.84%
Rosary Col.	3,103	24,251	12.80%
Elmira Col.	3,635	28,584	12.72%
Madonna Col.	3,966	31,215	12.71%
Mt. St. Joseph, Col. of	4,175	33,314	12.53%
Ohio Northern U.	7,805	62,986	12.39%
Alfred U.	9,167	74,322	12.33%
St. Joseph's U.	9,326	76,781	12.15%
Scranton, U. of	10,876	89,926	12.09%
Tampa, U. of	4,934	40,932	12.05%
Wilkes Col.	6,178	51,848	11.92%
Beaver Col.	3,308	27,947	11.84%
Hartford, U. of	18,264	155,476	11.75%
Pacific Lutheran U.	10,975	95,839	11.45%
Puget Sound, U. of	12,248	111,187	11.02%
Loyola Col.	10,524	96,021	10.96%
Le Moyne Col.	4,587	42,912	10.69%
Depaul U.	20,973	196,672	10.66%
Providence Col.	11,240	105,782	10.63%
Creighton U.	28,454	268,359	10.60%
Manhattan Col.	6,285	60,924	10.32%
San Diego, U. of	12,711	123,499	10.29%
Roosevelt U.	7,132	69,366	10.28%
Elmhurst Col.	4,544	44,198	10.28%
Elizabethtown Col.	3,326	32,397	10.27%
St. Francis Col.	3,071	29,991	10.24%
Rochester Inst. Tech.	33,848	331,695	10.20%
Upsala Col.	3,040	29,867	10.18%
St. Michael's Col.	4,909	49,744	9.87%
Maryville Col. St. Louis	2,852	29,098	9.80%
St. Edward's U.	3,539	36,265	9.76%
Lynchburg Col.	4,130	43,708	9.45%
Mercyhurst Col.	3,032	32,697	9.27%
Dayton, U. of	23,714	258,538	9.17%
King's Col. PA	4,099	44,803	9.15%
Simmons Col.	7,950	86,901	9.15%
New Rochelle, Col. of	5,263	58,753	8.96%
La Verne, U. of	5,846	66,296	8.82%
St. John Fisher Col.	2,564	29,394	8.72%
St. Bonaventure U.	5,363	61,852	8.67%
Iona Col.	7,600	87,785	8.66%
Villanova U.	20,522	240,041	8.55%
Columbia Col. MO	2,065	25,571	8.08%

TABLE 3, continued

Institution	Total Donations	Total Revenues	Donative %
Niagara U.	3,647	45,759	7.97%
Bridgeport, U. of	10,393	130,417	7.97%
Springfield Col.	2,509	32,886	7.63%
Park Col.	1,438	18,929	7.60%
Chaminade U. of Honolulu	1,841	24,386	7.55%
Merrimack Col.	2,676	35,787	7.48%
Wagner Col.	3,264	43,871	7.44%
St. Peter's Col.	4,538	61,448	7.39%
Pacific, U. of the	17,626	243,125	7.25%
Anna Maria Col.	949	13,690	6.93%
Mercy Col. of Detroit	2,512	37,967	6.62%
Gannon U.	4,338	66,315	6.54%
Salve Regina-Newport Col.	2,314	36,049	6.42%
Georgian Court Col.	1,329	20,793	6.39%
Quinnipiac Col.	3,656	57,900	6.31%
Webster U.	5,357	85,630	6.26%
York Col. of Pennsylvania	2,167	35,702	6.07%
Widener U.	7,181	118,824	6.04%
Seton Hall U.	12,009	213,893	5.61%
Loyola U. New Orleans	6,529	117,768	5.54%
Point Park Col.	1,301	24,580	5.29%
Russell Sage Col.	3,322	63,034	5.27%
Marist Col.	4,629	89,156	5.19%
Nazareth Col. of Rochester	2,139	43,209	4.95%
Hew Haven, U. of	2,402	48,845	4.92%
St. Joseph's Col. ME	777	16,178	4.80%
St. Rose, Col. of	1,760	41,391	4.25%
Ithaca Col.	5,998	142,219	4.22%
Franklin Pierce Col.	1,135	27,031	4.20%
Pace U.	8,672	213,063	4.07%
Western New Eng. Col.	2,625	66,134	3.97%
Utica Col. of Syracuse U.	1,128	29,576	3.81%
Emerson Col.	2,357	62,807	3.75%
St. Leo Col.	1,348	38,961	3.46%
Fairleigh Dickinson U.	6,720	260,381	2.58%
New York Inst. Tech.	4,102	242,693	1.69%
St. Thomas Aquinas Col.	118	14,815	0.80%

TABLE 4

Donations as a Percentage of Revenues 1986–1988

Liberal Arts Institutions

(in thousands)[258]

Institution	Total Donations	Total Expenditures	Total Revenues	Donative %
Catawba Col.	21,643	22,125	22,280	97.14%
Pomona Col.	83,269	86,671	87,278	95.41%
Scripps Col.	22,711	31,020	31,237	72.71%
Reed Col.	36,225	49,924	50,273	72.06%
Claremont McKenna Col.	27,348	41,194	41,482	65.93%
Eureka Col.	7,586	11,806	11,889	63.81%
Cenre Col. of Ky.	17,078	27,016	27,205	62.77%
Ozarks, U. of the	5,490	8,831	8,893	61.74%
Hillsdale Col.	21,756	35,207	35,453	61.36%
Presbyterian Col. .	13,926	23,807	23,974	58.09%
Warren Wilson Col.	9,119	16,169	16,282	56.01%
Schreiner Col.	8,135	14,504	14,606	55.70%
Bethel Col. TN	3,845	6,920	6,968	55.18%
Lincoln Mem. U.	10,570	19,044	19,177	55.12%
King Col.	8,527	15,718	15,828	53.87%
Mills Col.	25,443	49,329	49,674	51.22%
Beloit Col.	20,359	39,597	39,874	51.06%
Wells Col.	10,423	20,372	20,515	50.81%
Huntingdon Col.	6,835	13,390	13,484	50.69%
Culver-Stockton Col.	9,366	18,744	18,875	49.62%
Oakwood Col.	8,513	17,076	17,196	49.51%
Millsaps Col.	16,246	32,986	33,217	48.91%
Converse Col.	13,433	27,705	27,899	48.15%
Wash. Col.	12,751	26,629	26,815	47.55%
Wash. & Jeff. Col.	15,258	32,209	32,434	47.04%
Judson Col. AL	2,656	5,622	5,661	46.91%
Bridgewater Col.	9,008	19,370	19,506	46.18%
Wofford Col.	10,376	22,468	22,625	45.86%
Georgetown Col.	9,647	20,965	21,112	45.69%
Greenville Col.	6,483	14,094	14,193	45.68%
Bethel Col. KS	8,195	17,911	18,036	45.44%
Wilson Col.	6,261	13,763	13,859	45.18%
Bradford Col.	5,728	12,625	12,713	45.05%
Whitman Col.	21,094	47,067	47,396	44.51%
Notre Dame Col. of Ohio	4,390	9,902	9,971	44.03%
Davidson Col.	29,064	65,640	66,099	43.97%
Birmingham So. Col.	19,777	45,275	45,592	43.38%
McPherson Col.	6,003	13,745	13,841	43.37%
Emory & Henry Col.	7,924	18,223	18,351	43.18%
Wabash Col.	14,918	34,466	34,707	42.98%
Wheaton Col. IL	32,700	76,170	76,703	42.63%
Colorado Col.	32,561	75,952	76,484	42.57%

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258. The sources and methodology for this table are the same as in Table 1. *See supra* note 251.

The Total Revenues were derived by multiplying education and general expenditures by 1.007. *See* BARBETT ET. AL., *supra* note 221, at 7, tbl. T–5 (expenditures for baccalaureate institutions averaged 99.3% of revenues).

TABLE 4, continued

Institution	Total Donations	Total Expenditures	Total Revenues	Donative %
Hampden Sydney.Col.	13,024	30,854	31,070	41.92%
Lafayette Col.	36,853	88,580	89,200	41.31%
Coe Col.	12,405	29,921	30,130	41.17%
Wiley Col.	4,963	11,997	12,081	41.08%
Columbia Union Col.	8,133	19,732	19,870	40.93%
Nebraska Wesleyan U.	10,238	24,875	25,049	40.87%
Wellesley Col.	57,148	139,112	140,086	40.80%
Mount Holyoke Col.	41,803	104,347	105,077	39.78%
Atlantic Union Col.	6,705	16,767	16,884	39.71%
Wesleyan Col.	5,630	14,355	14,455	38.95%
Union Col. NE	6,455	16,460	16,575	38.94%
Hanover Col.	8,002	20,436	20,579	38.88%
Westminster Col. MO	6,796	17,365	17,487	38.86%
Rhodes Col.	18,462	47,189	47,519	38.85%
Vassar Col.	42,741	110,897	111,673	38.27%
Austin Col.	15,284	39,711	39,989	38.22%
Mt. Vernon Nazarene Col.	8,114	21,162	21,310	38.08%
Smith Col.	70,252	183,899	185,186	37.94%
Hope Col.	24,735	64,912	65,366	37.84%
Trinity Christian Col.	2,490	6,558	6,604	37.70%
Southwestern U.	16,154	42,888	43,188	37.40%
Franklin Col. of Indiana	8,906	23,663	23,829	37.38%
Depauw U.	27,723	74,386	74,907	37.01%
Livingston Col.	5,252	14,110	14,209	36.96%
Kalamazoo Col.	18,465	49,760	50,108	36.85%
Kansas Newman Col.	3,931	10,597	10,671	36.84%
Williams Col.	44,277	120,246	121,088	36.57%
Wilberforce U.	7,089	19,267	19,402	36.54%
Ripon Col.	10,104	27,489	27,681	36.50%
Bowdoin Col.	30,715	83,925	84,512	36.34%
Maryville Col.	7,935	21,855	22,008	36.06%
Iowa Wesleyan Col.	4,967	13,689	13,785	36.03%
Hartwick Col.	18,824	52,070	52,434	35.90%
Randoph-Macon Col.	10,488	29,020	29,223	35.89%
Dana Col.	4,790	13,272	13,365	35.84%
Lawrence U.	18,253	50,759	51,114	35.71%
So. Nazarene U.	7,788	21,836	21,989	35.42%
Rust Col.	6,937	19,500	19,637	35.33%
Asbury Col.	7,482	21,064	21,211	35.27%
Campbellsville Col.	4,892	13,823	13,920	35.14%
Mount Union Col.	8,400	23,743	23,909	35.13%
Hendrix Col.	6,377	18,189	18,316	34.82%
Grinnell Col.	23,285	66,679	67,146	34.68%
Central Method. Col.	6,669	19,199	19,333	34.49%
Goshen Col.	9,459	27,233	27,424	34.49%
Dubuque, U. of	8,312	23,966	24,134	34.44%
Gordon Col.	9,537	27,665	27,859	34.23%
Lubbock Christian U.	5,679	16,527	16,643	34.12%
Middlebury Col.	33,942	99,242	99,937	33.96%
Missouri Baptist Col.	1,555	4,547	4,579	33.96%
Pacific Union Col.	12,389	36,415	36,670	33.79%
Randoph-Macon Women's Col.	11,641	34,544	34,786	33.46%
Monmouth Col.	9,293	27,637	27,830	33.39%
Colby-Sawyer Col.	5,489	16,418	16,533	33.20%
Phillips U.	7,705	23,205	23,367	32.97%

TABLE 4, continued

Institution	Total Donations	Total Expenditures	Total Revenues	Donative %
Midland Lutheran Col.	5,932	17,904	18,029	32.90%
Swarthmore Col.	34,390	104,267	104,997	32.75%
Neumann Col.	4,712	14,298	14,398	32.73%
Friends U.	6,743	20,528	20,672	32.62%
Furman U.	21,502	66,505·	66,971	32.11%
Hamilton Col.	28,152	87,246	87,857	32.04%
Clarke Col.	4,499	13,963	14,061	32.00%
Paine Col.	5,886	18,271	18,399	31.99%
Claflin Col.	4,842	15,086	15,192	31.87%
Concordia Col.	8,405	26,240	26,424	31.81%
Earlham Col.	14,962	46,741	47,068	31.79%
Ozarks, School of the	14,139	44,474	44,785	31.57%
Amherst Col.	34,633	109,024	109,787	31.55%
Jamestown Col.	4,901	15,494	15,602	31.41%
Concordia Lutheran Col.	1,987	6,283	6,327	31.41%
Hollins Col.	10,640	33,754	33,990	31.30%
Berry Col.	15,114	47,968	48,304	31.29%
Eastern Mennonite Col.	7,183	22,798	22,958	31.29%
Canadian Union Col.	4,019	· 12,762	12,851	31.27%
Willamette U.	19,672	62,656	63,095	31.18%
Wash. & Lee U.	21,397	68,547	69,027	31.00%
Westmar Col.	3,353	10,767	10,842	30.92%
Simpson Col.	7,830	25,191	25,367	30.87%
Sioux Falls Col.	3,919	12,733	12,822	30.56%
Davis & Elkins Col.	4,831	15,710	15,820	30.54%
Wheaton Col. MA	16,320	53,569	53,944	30.25%
Lake Forest Col.	14,258	47,611	47,944	29.74%
Oberlin Col.	15,425	52,208	52,573	29.34%
Northwestern Col.	5,611	19,143	19,277	29.11%
Brescia Col.	3,286	11,212	11,290	29.10%
Kenyon Col.	17,220	59,321	59,736	28.83%
Greensboro Col.	2,896	9,987	10,057	28.80%
Dordt Col.	5,515	19,175	19,309	28.56%
Roanoke Col.	10,717	37,316	37,577	28.52%
Guilford Col.	9,560	33,311	33,544	28.50%
Central Wesleyan Col.	2,779	9,749	9,817	28.31%
South, U. of the	17,298	61,259	61,688	28.04%
Queens Col.	6,500	23,056	23,217	28.00%
Bethany Col. KS	5,405	19,175	19,309	27.99%
Albion Col.	12,442	44,243	44,553	27.93%
Newberry Col.	5,608	19,991	20,131	27.86%
Carleton Col.	24,011	85,746	86,346	27.81%
Roberts Wesleyan Col.	4,923	17,714	17,838	27.60%
Pine Manor Col.	5,528	19,954	20,094	27.51%
Kentucky Wesleyan Col.	4,257	15,456	15,564	27.35%
Mars Hill Col.	8,271	30,044	30,254	27.34%
Southwestern Adventist Col.	3,437	12,503	12,591	27.30%
Bates Col.	17,600	64,140	64,589	27.25%
Trevecca Nazarene Col.	4,882	17,884	18,009	27.11%
Tusculum Col.	4,626	17,078	17,198	26.90%
Houghton Col.	7,802	29,014	29,217	26.70%
Ogelthorpe U.	5,280	19,653	19,791	26.68%
Wooster, Col. of	19,927	74,287	74,807	26.64%
Arkansas Col.	5,345	19,998	20,138	26.54%
Sweet Briar Col.	8,883	33,263	33,496	26.52%

TABLE 4, continued

Institution	Total Donations	Total Expenditures	Total Revenues	Donative %
Franciscan U. Steubenville	3,515	13,208	13,300	26.43%
Illinois Col.	4,808	18,298	18,426	26.09%
Hobart & Wm. Smith Col.	19,193	73,397	73,911	25.97%
Ohio Wesleyan U.	16,202	62,152	62,587	25.89%
Lake Erie Col.	5,014	19,338	19,473	25.75%
Occidental Col.	19,358	74,714	75,237	25.73%
Bennett Col.	2,526	9,859	9,928	25.44%
Cornell Col.	7,785	30,620	30,834	25.25%
Adrian Col.	6,829	27,103	27,293	25.02%
Lebanon Valley Col.	6,726	26,859	27,047	24.87%
Mary Baldwin Col.	7,751	31,023	31,240	24.81%
Salem Col. NC	4,829	19,367	19,503	24.76%
Colgate Univ.	29,397	118,271	119,099	24.68%
Olivet Col.	4,451	17,970	18,096	24.60%
Virginia Wesleyan Col.	5,041	20,885	21,031	23.97%
Virginia Union U.	6,382	26,681	26,868	23.75%
Trinity Col. DC	4,895	20,657	20,802	23.53%
Bryan Col.	2,599	11,002	11,079	23.46%
Haverford Col.	13,589	57,669	58,073	23.40%
Holy Cross, Col. of the	19,127	81,257	81,826	23.38%
Goucher Col.	9,501	40,380	40,663	23.37%
St. Joseph's Col. IN	5,825	25,001	25,176	23.14%
Gustavus Adolphus Col.	13,547	58,183	58,590	23.12%
Trinity Col. CT	21,936	94,359	95,020	23.09%
Wartburg Col.	7,571	32,616	32,844	23.05%
St. Mary-of-the-Woods Col.	3,180	13,805	13,902	22.88%
Mount St. Mary's Col.	8,023	34,879	35,123	22.84%
Geneva Col.	4,930	21,493	21,643	22.78%
Ursuline Col.	3,675	16,026	16,138	22.77%
St. Paul's Col.	4,270	18,665	18,796	22.72%
Judson Col. IL	3,550	15,562	15,671	22.65%
Graceland Col.	3,800	16,705	16,822	22.59%
Keuka Col.	3,084	13,582	13,677	22.55%
Skidmore Col.	20,036	88,480	89,099	22.49%
Alma Col.	8,087	35,917	36,168	22.36%
Allegheny Col.	14,286	63,510	63,955	22.34%
Pikeville Col.	3,327	14,835	14,939	22.27%
Antioch U.	15,106	67,781	68,255	22.13%
Dillard U.	6,411	28,791	28,993	22.11%
Eastern Col.	4,981	22,406	22,563	22.08%
Bethany Col. WV	6,072	27,491	27,683	21.93%
Thiel Col.	5,441	24,844	25,018	21.75%
Rosemont Col.	3,632	16,599	16,715	21.73%
Averett Col.	4,053	18,939	19,072	21.25%
Concordia Col. St. Paul	4,327	20,245	20,387	21.22%
Gettysburg Col.	15,035	70,657	71,152	21.13%
St. John's U. MN	10,733	50,616	50,970	21.06%
Connecticut Col.	15,730	74,276	74,796	21.03%
Cedar Crest Col.	4,308	20,424	20,567	20.95%
Seton Hill Col.	4,732	22,456	22,613	20.93%
Doane Col.	3,809	18,122	18,249	20.87%
Viterbo Col.	4,352	20,799	20,945	20.78%
St. Olaf Col.	18,682	89,804	90,433	20.66%
Spalding U.	2,762	13,308	13,401	20.61%
Muskingum Col.	6,856	33,133	33,365	20.55%

TABLE 4, continued

Institution	Total Donations	Total Expenditures	Total Revenues	Donative %
Hamline U.	11,094	54,943	55,328	20.05%
Tri-State U.	4,640	23,097	23,259	19.95%
Macalester Col.	13,153	66,008	66,470	19.79%
Blackburn Col.	2,998	15,047	15,152	19.79%
Westmont Col.	6,794	34,151	34,390	19.76%
Sarah Lawrence Col.	8,871	44,677	44,990	19.72%
Taylor U.	5,569	28,133	28,330	19.66%
Juniata Col.	7,197	36,391	36,646	19.64%
Hiram Col.	6,567	33,293	33,526	19.59%
Chatham Col.	4,292	21,846	21,999	19.51%
Briar Cliff Col.	3,997	20,834	20,980	19.05%
Defiance Col.	3,789	19,776	19,914	19.03%
Marylhurst Col.	2,069	10,952	11,029	18.76%
Felician Col.	1,689	8,954	9,017	18.73%
Eckerd Col.	8,051	42,716	43,015	18.72%
Colby Col.	14,586	77,455	77,997	18.70%
Bucknell U.	25,055	133,302	134,235	18.67%
High Point Col.	2,843	15,144	15,250	18.64%
Augustana Col. IL	9,509	51,049	51,406	18.50%
Stephens Col.	5,679	30,585	30,799	18.44%
Lycoming Col.	5,623	30,867	31,083	18.09%
William Penn Col.	1,967	10,810	10,886	18.07%
Notre Dame, Col. of	3,350	18,501	18,631	17.98%
Knox Col.	6,696	37,356	37,617	17.80%
Bennington Col.	5,927	33,181	33,413	17.74%
Mary Hardin Baylor, U.	3,720	20,936	21,083	17.64%
Incarnate Word Col.	5,536	31,598	31,819	17.40%
Franklin & Marshall Col.	14,862	84,932	85,527	17.38%
Mobile Col.	2,611	15,049	15,154	17.23%
Mary, U. of	3,541	20,438	20,581	17.21%
Carthage Col.	4,748	27,529	27,722	17.13%
Columbia Col. SC	3,838	22,568	22,726	16.89%
Wittenberg U.	11,991	70,572	71,066	16.87%
Wesleyan U.	26,282	155,166	156,252	16.82%
Morningside Col.	4,144	25,301	25,478	16.26%
Muhlenberg Col.	8,413	51,815	52,178	16.12%
Grand View Col.	3,269	20,214	20,355	16.06%
Regis Col. MA	5,208	32,327	32,553	16.00%
Luther Col.	7,665	48,932	49,275	15.56%
Salem Col. WV	2,883	18,771	18,902	15.25%
Carroll Col. WI	6,004	39,156	39,430	15.23%
Western Maryland Col.	6,561	42,880	43,180	15.19%
St. Lawrence U.	14,339	95,245	95,912	14.95%
Holy Names Col.	2,487	16,673	16,790	14.81%
St. Mary's Col. Minn.	5,339	35,809	36,060	14.81%
Union Col. NY	14,873	101,081	101,789	14.61%
Wilmington Col.	3,614	24,698	24,871	14.53%
Lenoir-Rhyne Col.	4,713	32,249	32,475	14.51%
Barnard Col.	13,735	94,754	95,417	14.39%
Marymount Manhattan Col.	4,528	31,321	31,540	14.36%
Pitzer Col.	3,353	23,427	23,591	14.21%
Chestnut Hill Col.	2,076	14,741	14,844	13.99%
Pacific U.	5,649	40,962	41,249	13.69%
Kendall Col.	829	6,030	6,072	13.65%
St. Scholastica, Col. of	4,537	33,172	33,404	13.58%

TABLE 4, continued

Institution	Total Donations	Total Expenditures	Total Revenues	Donative %
Mundelien Col.	2,912	21,425	21,575	13.50%
Denison U.	7,156	52,887	53,257	13.44%
Hampshire Col.	4,450	33,754	33,990	13.09%
St. Joseph Col.	3,398	26,090	26,273	12.93%
Barat Col.	905	6,964	7,013	12.91%
Dallas, U. of	4,941	38,585	38,855	12.72%
Quincy Col.	2,721	21,656	21,808	12.48%
MacMurray Col.	2,236	18,028	18,154	12.32%
Belmont Abbey Col.	2,065	16,970	17,089	12.08%
Malone Col.	1,483	12,234	12,320	12.04%
Radcliffe Col.	14,246	119,565	120,402	11.83%
Atlantic Christ. Col.	2,908	24,588	24,760	11.74%
Westminster Col. PA	4,272	37,636	37,899	11.27%
Albright Col.	4,514	40,106	40,387	11.18%
Alverno Col.	1,993	18,005	18,131	10.99%
Dickinson Col.	8,294	75,245	75,772	10.95%
Immaculate Col.	2,069	19,080	19,214	10.77%
Fresno Pac. Col.	2,207	20,648	20,793	10.61%
Trinity Col. VT	1,438	13,601	13,696	10.50%
Ohio Domenican Col. ·	2,089	19,869	20,008	10.44%
Mckendree Col.	1,455	14,152	14,251	10.21%
Mount St. Mary Col.	1,828	17,808	17,933	10.19%
Siena Heights Col.	3,521	34,463	34,704	10.15%
Marymount Col.	3,486	36,489	36,744	9.49%
Goddard Col.	692	7,256	7,307	9.47%
Heidel berg Col.	3,151	34,004	34,242	9.20%
Lewis & Clark Col.	7,779	84,967	85,562	9.09%
St. Anselm Col.	4,074	46,445	46,770	8.71%
Upper Iowa U.	739	8,473	8,532	8.66%
Wesley Col.	1,391	16,739	16,856	8.25%
Findlay Col.	2,618	31,536	31,757	8.24%
Our Lady of the Elms Col.	1,404	17,276	17,397	8.07%
Cabrini Col.	1,300	16,095	16,208	8.02%
Emmanuel Col.	1,691	21,659	21,811	7.75%
Caldwell Col.	668	8,633	8,693	7.68%
Benedict Col.	2,683	36,349	36,603	7.33%
Spring Hill Col.	1,771	24,541	24,713	7.17%
So. Vermont Col.	528	7,318	7,369	7.16%
Manhattanville Col.	2,988	42,441	42,738	6.99%
St. Joseph's Col. NY	1,476	26,856	27,044	5.46%
Gallaudet U.	5,436	217,413	218,935	2.48%

TABLE 5

Summary of Donative Percentages

(numbers in thousands)

Category	Total Donations	Total Revenues	Average Donation %	Total Revenues Excluding Government Grants	Donative Percentage Excluding Government Grants
Research	6,535,152	37,308,578	17.52%	27,093,376	24.12%
Comprehensive	1,751,553	11,645,657	15.04%	10,748,941	16.30%
Liberal Arts	3,068,256	11,312,829	27.12%	10,336,174	29.68%
Totals	11,354,961	60,267,064	18.84%	48,178,491	23.57%