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The Billionaire's Treasure Trove: A Call to Reform Private Art Museums and the Private Benefit Doctrine

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The Billionaire's Treasure Trove: A Call to Reform Private Art Museums and the Private Benefit Doctrine*

E. Alex Kirk

Abstract

Thanks to the new generation of billionaire art collectors, and the recent boom in the art market, a growing number of high-net-worth patrons are creating their own tax-exempt private art museums. These “jewel-box” museums provide invaluable public benefits, lead to growth and innovation in the private museum sector, and encourage donors to pursue more avant-gardes collecting strategies. This advantageous tax-saving strategy appeals to wealthy individuals, who wish to maintain control over their art collection, and still receive generous charitable income tax deductions. However, several private museums have recently come under fire due to private benefit concerns. To qualify for federal tax exemption under section 501(c)(3) of the Internal Revenue Code, a private museum must serve public rather than private interests. Ambiguity in the regulatory scheme has allowed some high-net-worth individuals to exploit loopholes in the tax law, which is silent on how these private museums should comply with the public benefit requirement, and the types of activities that constitute substantial, and therefore, impermissible private benefits. The tax law is structured to incentivize charitable giving: Taxpayers can write off the cost of maintaining their art collections, subsidize the cost of newly purchased artworks, and leave behind a lasting philanthropic legacy. It is practically impossible for private museums to not provide some sort of private benefit. This Note proposes to reform the limitations on private benefit with flexible guidelines that allow for involvement during the donor's lifetime, provide these organizations with enough autonomy to carry out their unique charitable vision, and encourage charitable giving. Private benefit should continue to be assessed on a case-by-case basis, in consideration of the organization's available resources, size, and funding. Any updates in the regulatory scheme should not foreclose on these charitable deductions altogether, and should be narrowly tailored to prevent only those activities with substantial enough private benefits to justify the revocation of their tax-exempt status. Private museums that encourage public engagement with the arts and provide

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KEYWORDS: Billionaire, Art, Museums, Private Benefit, Tax

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INTRODUCTION

“Museums are very much a part of the community, but that role is not well understood and [has not] been well publicized.” – Ford Bell¹

Due to the efforts of many forward-thinking wealthy individuals, the private museum sector has helped to transform the cultural landscape in the United States. This modern-day private museum “Renaissance” has signaled a major shift in the nonprofit art sector.² Over ninety percent of artworks in American museums were donated by private collections, and some of the country’s most prized art museums started in private institutions.³ Part of the recent boom in the private museum sector is attributable to the “skyrocketing value of art and the growing number of collectors who buy it as an investment”⁴ Thanks to the new generation of high-net-worth art collectors, a growing number of patrons are creating their own private exhibition spaces. Rather than donate to more established public museums, taxpayers can create their own private tax-exempt museums, which receive generous federal charitable tax deductions, and allow wealthy individuals to “write off” their private art collections.⁵ Charitable deductions save art collectors millions of dollars by donating their art and assets to private operating foundations—“founders can deduct the full market value of any art, cash and stocks they donate, even when the museums are just a quick stroll from their living rooms.”⁶

Along with the prestige and power that accompanies the creation of one’s own private museum, donor-founders’ are charged

¹ *A History of Museums, ‘The Memory of Mankind,’* NAT’L PUB. RADIO (Nov. 24, 2008, 1:00 PM), <http://www.npr.org/templates/transcript/transcript.php?storyId=97377145> [<https://perma.cc/TY37-WSSQ>].

² Cat Weaver, *When Private Art Collectors Go Public. Part 1: Ego, Branding, Power and Taxes*, GALLERYINTELL (2013), <http://www.galleryintell.com/when-private-collectors-go-public-part-1/> [<https://perma.cc/3SY9-88J7>].

³ Patricia Cohen, *Writing Off the Warhol Next Door: Art Collectors Gain Tax Benefits from Private Museums*, N.Y. TIMES (Jan. 10, 2015), http://www.nytimes.com/2015/01/11/business/art-collectors-gain-tax-benefits-from-private-museums.html?_r=0 [<https://perma.cc/PZ2D-CFSG>] [hereinafter Cohen, *Writing Off the Warhol Next Door*].

⁴ *Id.*

⁵ *Id.*

⁶ *Id.*

with the social responsibility of providing meaningful public benefits.⁷ Any artworks placed in a tax-exempt museum become cultural relics that belong in the public domain. The Internal Revenue Code (the “Code”) imposes minimal requirements to qualify for federal tax-exemption under section 501(c)(3), and only mandates that private museums conduct charitable activities in furtherance of public, rather private interests.⁸ Museums are “steward[s] of the public trust,” and must appropriately dedicate their resources to serve the public good.⁹ These private “jewel-box museums”¹⁰ are compelling in the long run: They provide unique public benefits that their public counterparts cannot, encourage public engagement with the arts, and safeguard some of the most influential fine art collections for generations to come. But as the nonprofit sector continues to grow, so does the potential for abuse by nonprofit arts organizations that benefit from federal tax exemptions.¹¹ The Internal Revenue Service (the “IRS”) has failed to clearly outline what constitutes a substantial enough private benefit to outweigh the public benefit, and justify the revocation of an organization’s tax-exempt status.¹² Consequently, the private museum sector is left with little guidance on how to best carry out its charitable purposes.

Out of growing concern over whether these private operating foundations satisfy the public benefit requirement, Senator Orrin G. Hatch, Chairman of the Senate Finance Committee (the “Committee”), recently conducted a review of eleven private tax-exempt museums that focused on “the nature of the relationship

⁷ See Weaver, *supra* note 2.

⁸ For background information on section 501(c)(3) and the public benefit requirement, see generally *infra* Section I.A.

⁹ *Code of Ethics for Museums*, AM. ALLIANCE MUSEUMS (2000), <http://www.aam-us.org/resources/ethics-standards-and-best-practices/code-of-ethics> [<https://perma.cc/P78Y-HMN5>].

¹⁰ Cohen, *Writing Off the Warhol Next Door*, *supra* note 3.

¹¹ *Id.*

¹² See generally Letter from Orrin G. Hatch, Chairman, U.S. Senate Comm. on Fin., to John Koskinen, Comm’r, Internal Revenue Serv. (May 17, 2016), <http://www.finance.senate.gov/imo/media/doc/Letter%20to%20IRS%20on%20Private%20Museums.pdf> [<https://perma.cc/FXD8-DYKD>].

between the donor and museum,”¹³ summarizing his findings in a letter to IRS Commissioner John Koskinen.¹⁴ Senator Hatch launched the congressional inquiry (the “Inquiry”) in November 2015 to investigate “bedrock institutions . . . that have long enjoyed preferential tax treatment.”¹⁵ Several factors were taken into account: The three most glaring issues were the amount of donor control over the foundation’s governance and assets, the degree of access provided to the general public, and the type of private benefits, if any, these organizations impart on their founders.¹⁶ The Code appears to be fundamentally unfair if it is rigged in favor of wealthy art patrons who can create their own private exhibition spaces under the guise of a tax-exempt organization. Collectors may still be entitled to charitable tax deductions even if the organization affords the donor-founder significant private benefits, and is only open to the public on a limited basis, if at all. The investigation highlights the need to reevaluate whether these type of private museums should qualify for federal tax exemption, and if so, whether their tax-exempt status should be subject to certain limitations to ensure that these institutions’ activities are in furtherance of their charitable purposes.¹⁷ Unfortunately, the Committee failed to provide any explanation as to what standards should be in place, and how to resolve the ambiguities within the Code.¹⁸ The Inquiry sug-

¹³ Among those surveyed were: Brant Foundation Art Study Center in Greenwich, Connecticut; The Broad in Los Angeles, California; El Segundo Museum of Art in El Segundo, California; Fisher Landau Center for Art in Queens, New York; Glenstone in Potomac, Maryland; Goss-Michael Foundation in Dallas, Texas; Hall Art Foundation in Reading, Vermont; Kreeger Museum in Washington, D.C.; Linda Pace Foundation in San Antonio, Texas; Pier 24 in San Francisco, California; and Rubell Family Collection in Miami, Florida. *See* Letter from Orrin G. Hatch to John Koskinen, *supra* note 12.

¹⁴ Press Release, U.S. Senate Comm. on Fin., Hatch Concludes Review into Tax-Exempt Private Museums, Notes Concerning Findings (June 2, 2016), <http://www.finance.senate.gov/chairmans-news/hatch-concludes-review-into-tax-exempt-private-museums-notes-concerning-findings> [<https://perma.cc/KY8C-234P>].

¹⁵ Patricia Cohen, *Tax Status of Museums Questioned by Senators*, N.Y. TIMES (Nov. 29, 2015), <http://www.nytimes.com/2015/11/30/business/tax-status-of-museums-questioned-by-senators.html> [<https://perma.cc/J5U3-BR4H>] [hereinafter Cohen, *Tax Status of Museums Questioned by Senators*].

¹⁶ *Id.*

¹⁷ *See* Press Release, *supra* note 14.

¹⁸ May Harris & Linda Rosenthal, *Senate Review of Private Museums Ends with a Whimper*, FOR PURPOSE L. GROUP (July 14, 2016, 8:00 AM), <http://www.forpurpose.law.com/senate-review-private-museums-ends/> [<https://perma.cc/A4UP-AP4Y>] (observing

gests that some private museums may need to publicize how their charitable activities justify their tax-exempt status, or expand their facilities and programmatic efforts to better achieve their charitable purposes.¹⁹

To better understand the tax treatment of private museums and collectors in the United States, this Note explores the public benefit requirement under section 501(c)(3) of the Code, and the private benefit doctrine. Part I of this Note recounts the requirements for federal tax exemption, the historical landscape of charitable giving in the arts, and recent developments in the Code, which depart from the traditional model of donating to public art museums in favor of encouraging wealthy art patrons to create their own private art museums. Part II examines the importance of charitable deductions, and the regulatory scheme governing private operating foundations. Part III presents an overview of the private benefit doctrine that provides the necessary context for this Note. This Part describes the operational and organizational tests used to determine whether a private museum satisfies the public benefit requirement, and the quantitative and qualitative tests utilized to assess whether any private benefits conferred are substantial enough to warrant the revocation of an organization's tax-exempt status.

Part IV devotes considerable discussion to the regulatory challenges that result from the current body of law, and addresses the possibilities for updating the regulatory scheme. Given the complexity of the private benefit inquiry, this Note recommends that the IRS adopt flexible regulations and/or guidelines to help curb donor abuse, and evaluate private benefit on a case-by-case basis. Reform should aim to deter only those organizations that abuse the Code in furtherance of non-charitable purposes, rather than do away with the charitable deductions altogether. Though we want to control the dangers that excessive private benefits pose, there is concern that too stringent rules will destroy the majority of the tax benefits that incentivize donor participation in the private museum sector. Finally, Part V provides examples of how these private op-

that the Committee's "results are inconclusive; there are no clear commonalities or trends").

¹⁹ See Letter from Orrin G. Hatch to John Koskinen, *supra* note 12.

erating foundations should avoid private benefits that may jeopardize their tax-exempt status.

I. HISTORICAL DEVELOPMENT OF PRIVATE ART MUSEUMS

“At its core, a museum is an educational organization. Its primary purpose is to collect objects deemed worthy of preservation and to instruct the public through the presentation of exhibits and other activities generated by critical collecting.”²⁰

A museum is defined as “a public or private nonprofit institution . . . organized on a permanent basis for essentially educational and aesthetic purposes and which, using a professional staff . . . ” owns or acquires, cares for, and exhibits works of art on a regular schedule.²¹ There are as many as 17,000 museums in the United States, which draw crowds of more than 800 million people annually.²² Generally, a museum’s primary mission is to display objects and artworks from its collection, and provide access to the public for educational and scholarly purposes.²³ The act of accessioning an artwork bestows a particular set of values.²⁴ Museums play a vital role in curating their own canons of art history, and must act as “moral institutions.”²⁵ Section I.A sets forth the requirements for private art museums to qualify for federal tax exemption under section 501(c)(3) of the Code, and Section I.B illustrates the rationale for wealthy art collectors to create their own private foundations, rather than donate to more established public organizations.

²⁰ 2 RALPH E. LERNER & JUDITH BRESLER, *ART LAW: THE GUIDE FOR COLLECTORS, INVESTORS, DEALERS, & ARTISTS* 1341 (4th ed. 2012).

²¹ 2 C.F.R. § 3187.3(a)(1)–(3) (2017).

²² Leila John, Comment, *Museums and the Tax Collector: The Tax Treatment of Museums at the Federal, State, and Local Level*, 15 U. PA. J. BUS. L. 877, 883 (2013).

²³ Roberta Frey Gilboe, *Museum Acquisitions 101: A Primer for Collectors*, 1 *ART & MUSEUM L.J.* 105, 107 (2006).

²⁴ LERNER & BRESLER, *supra* note 20, at 1477; *see also supra* note 9 and accompanying text.

²⁵ Sue Hubbard, *Personality of the Year*, *APOLLO*, Dec. 1, 2010, at 26, 29 (quoting Sam Keller, Director of Fondation Beyeler).

A. Requirements for Section 501(c)(3) Federal Tax Exemption

The IRS's charitable deduction-related regulation is the broadest method of oversight for the private museum sector, as there is little regulation of the art world.²⁶ Section 501(c)(3) of the Code provides income tax exemption for organizations that qualify as "[c]orporations, and any community chest, fund, or foundation, organized and operated exclusively for . . . educational purposes"²⁷ Art museums qualify as an educational tax-exempt entity.²⁸ Museums are civic centers: Art collections are held in a "[c]ustodial trust"²⁹ that confers an intrinsic duty to satisfy the public benefit requirement.³⁰ Ownership of a private tax-exempt exhibition space imposes an obligation for the founder to provide meaningful community and cultural engagement beyond mere connoisseurship.³¹ These tax-exempt organizations provide unique

²⁶ See *infra* note 64 and accompanying text.

²⁷ I.R.C. § 501(c)(3) (2012). Educational organizations are required to provide either: "(a) [t]he instruction or training of the individual for the purpose of improving or developing his capabilities; or (b) the instruction of the public on subjects useful to the individual and beneficial to the community." Treas. Reg. § 1.501(c)(3)-1(d)(3)(i) (2017).

²⁸ *Goldsboro Art League, Inc. v. Comm'r*, 75 T.C. 337, 343 (1980). Educational organizations include: "[m]useums, zoos, planetariums, symphony orchestras, and other similar organizations." § 1.501(c)(3)-1(d)(3)(ii), Ex. (4).

²⁹ Herrington J. Bryce, *The Public's Trust in Nonprofit Organizations: The Role of Relationship Marketing and Management*, 49 CAL. MGMT. REV. 112, 122 (2007) (This trust is "recognized in nonprofit law, governance, and financial management, because all nonprofits are composed of, hold, and operate social assets for the benefit of a group or society.").

³⁰ SMITHSONIAN INST. OFFICE OF POLICY & ANALYSIS, ART MUSEUMS AND THE PUBLIC 1, 14 (2001), <https://www.si.edu/Content/opanda/docs/Rpts2001/01.10.ArtPublic.Final.pdf> [<https://perma.cc/3MZT-377F>]. Museum programming should ensure:

[P]rograms support its mission and public trust responsibilities[;] . . . programs are accessible and encourage participation of the widest possible audience consistent with its mission and resources[;] programs respect pluralistic values, traditions and concerns[;] revenue-producing activities and activities that involve relationships with external entities are compatible with the museum's mission and support its public trust responsibilities[; and] programs promote the public good rather than individual financial gain.

Code of Ethics for Museums, *supra* note 9.

³¹ SMITHSONIAN INST. OFFICE OF POLICY & ANALYSIS, *supra* note 9, at 5 (citing STEPHEN E. WEIL, *The Proper Business of the Museum: Ideas or Thing?*, in RETHINKING THE MUSEUM AND OTHER MEDITATIONS 43, 50 (1990)). See generally *infra* Section III.B.1 (explaining that a private museum's true purposes must be in furtherance of the public benefit). A private museum should *actively* conduct activities that are *directly* related to its

public benefits through exhibitions, educational programming, community outreach, and tourism revenue.³² Museums not only have a tremendous impact on “the representation of a community and its highest values and truths,” but also help “define the relative standing of individuals within that community.”³³ Consequently, those in control of museums determine “[w]hat we see and do not see in art museums—and on what terms and by whose authority we do or do not see it.”³⁴ The level of influence these founders have over the “cultural experience[s]” in their communities is inexorably linked to the public benefit of these institutions, and this complex relationship is primarily the reason why these private museums have become the subject of such fierce scrutiny.³⁵

B. Billionaire “Super Collectors” and the Proliferation of the Private Museum

The burgeoning private art museum sector in the United States is not a new trend.³⁶ Since the nineteenth century, notable art patrons and philanthropists in the United States have devoted invaluable resources to form their own private museums.³⁷ As the audience for museums matured throughout the nineteenth century, the public grew to appreciate the cultural value and immense transformative power of these public exhibition spaces.³⁸ During the twentieth century, the general consensus among the art world cognoscenti shifted away from this ideal toward the modern view of the “aesthetic” museum,³⁹ as more private collectors “were simply being more true to their own calling than to existing institu-

declared tax-exempt educational purposes. Treas. Reg. § 53.4942(b)-2(a)(2)(i) (2017) (emphasis added); *cf.* § 53.4942(b)-2(a)(6), Ex. (2).

³² John, *supra* note 22, at 891.

³³ Carol Duncan, *The Art Museum as Ritual*, in *THE ART OF ART HISTORY: A CRITICAL ANTHOLOGY* 424, 425 (Donald Preziosi ed., 2d ed. 2009).

³⁴ *Id.*

³⁵ *See id.*

³⁶ *See, e.g.*, Leonard F. Charla, *Museum Acquisition Transactions: Issues for Sellers and Donors of Art Collections*, 1 *ART & MUSEUM L.J.* 157, 159–60 (2006).

³⁷ ASS’N OF ART MUSEUM DIRS., *ART MUSEUMS, PRIVATE COLLECTORS, AND THE PUBLIC BENEFIT* 1, 1 (2007), <https://aamd.org/sites/default/files/document/PrivateCollectors3.pdf> [<https://perma.cc/FQ3M-JSLR>] [hereinafter *PRIVATE COLLECTORS, AND THE PUBLIC BENEFIT*].

³⁸ *See* Duncan, *supra* note 33, at 432.

³⁹ *See id.* at 430.

tions.”⁴⁰ Given the rising popularity of private museums in Europe, the opportunity for connoisseurship attracted many wealthy individuals in the United States, who desired to amass world-class art collections that would come to rival their more storied European counterparts.⁴¹ Several prominent museums in the United States started off as private collections, including the Isabella Stewart Gardner Museum, J. Paul Getty Museum, Frick Collection, Barnes Foundation, and Morgan Library and Museum.⁴² These private museums help to define “the cultural landscape for generations” within the United States.⁴³

Today, there are more than forty-three private art museums in the United States, the second-highest number of private museums in the world.⁴⁴ This number has skyrocketed since 2000,⁴⁵ correlating with the overall growth of philanthropic efforts within the arts and culture charitable sector.⁴⁶ In 2015, the national average for total charitable giving in the United States rose by an average of

⁴⁰ David D’Arcy, *Making a Show of It: A Look at the Rising Trend that Sees Art Buyers Creating Their Own Museums*, NATIONAL (Aug. 13, 2016), <http://www.thenational.ae/arts-life/art/20160813/making-a-show-of-it-a-look-at-the-rising-trend-that-sees-art-buyers-creating-their-own-museums#full> [<https://perma.cc/J3P8-HAN2>].

⁴¹ See Charla, *supra* note 36.

⁴² See, e.g., Cohen, *Tax Status of Museums Questioned by Senators*, *supra* note 15; Michael Shnayerson, *Inside the Private Museums of Billionaire Art Collectors*, TOWN & COUNTRY (Jan. 16, 2017), <http://www.townandcountrymag.com/leisure/arts-and-culture/a9124/private-museums-of-billionaires/> [<https://perma.cc/8RBT-SCA4>].

⁴³ D’Arcy, *supra* note 40 (“Barnes’s own wall arrangements were sacrosanct.”); see also *infra* Section III.B.1 (providing background information on the history of the Barnes Foundation).

⁴⁴ Julia Halperin, *US Senate Committee Submits Private Museum Findings to Internal Revenue Service*, ART NEWSPAPER (June 2, 2016), <http://theartnewspaper.com/news/us-senate-committee-submits-private-museum-findings-to-internal-revenue-service/> [<https://perma.cc/6NCK-YEN4>] (attributing the count to the collector’s database “Larry’s List”).

⁴⁵ Jessie A. Crawford, *Art for One or Art for All? Exploring the Role and Impact of Private Collection Museums in the United States* 39 (2016) (unpublished B.A. thesis, Ohio State University) (on file with the Fordham Intellectual Property, Media & Entertainment Law Journal). “[Fifty-three percent] of the world’s private contemporary art museums were founded between 2001 and 2010,” of which eighteen percent were founded since 2010. Benjamin Sutton, *Crunching the Numbers Behind the Boom in Private Art Museums*, HYPERALLERGIC (Jan. 21, 2016), <http://hyperallergic.com/269548/crunching-the-numbers-behind-the-boom-in-private-art-museums/> [<https://perma.cc/47UG-WQFQ>].

⁴⁶ Crawford, *supra* note 45, at 19.

4.1% over the previous year—total giving by individuals increased by 3.8%, totaling \$264.68 billion; whereas charitable giving within the arts and cultural sector increased by seven percent, totaling an estimated \$17.07 billion.⁴⁷ The recent boom in the number of private museums can be attributed, in part, to the massive influx in disposable income, “an insatiable public interest in art,” and a desire to benchmark one’s social and financial status (keeping up with the Joneses).⁴⁸ The eleven private art foundations that Senator Hatch reviewed collectively have assets worth more than \$1.6 billion.⁴⁹ Moreover, the increase in the number of private museums has deeply impacted the public art museum sector.⁵⁰ The majority of museums tend to rely primarily on wealthy donors, rather than government funding.⁵¹ More established museums struggle to keep up with the rapidly increasing art market, and are often outbid at auction by wealthy collectors.⁵² Private museums tend to be richer institutions than their public counterparts: These institutions require large endowments to guarantee their long-term survival,⁵³ and require an immense amount of capital—especially for those that collect contemporary art.⁵⁴ Though these smaller private institutions are unlikely to entirely supplant funding of more estab-

⁴⁷ *Giving USA: 2015 Was America’s Most-Generous Year Ever*, GIVING USA (June 13, 2016), <https://givingusa.org/giving-usa-2016/> [<https://perma.cc/64S3-HMSJ>]; cf. Crawford, *supra* note 45, at 19 (noting that in 2014, the national average for charitable giving in the United States rose by an average of 7.1%, whereas charitable giving within the arts and cultural sector increased by 9.2%—the largest percentage of growth for any of the charitable subsectors).

⁴⁸ Carol Kino, *Welcome to the Museum of My Stuff*, N.Y. TIMES (Feb. 18, 2007), <http://www.nytimes.com/2007/02/18/arts/design/18kino.html> [<https://perma.cc/72C3-FUWC>].

⁴⁹ Halperin, *supra* note 44 (referring to the eleven organizations’ 2013 tax returns).

⁵⁰ See Kino, *supra* note 48.

⁵¹ *Museum Facts*, AM. ALLIANCE MUSEUMS, <http://www.aam-us.org/about-museums/museum-facts> [<https://perma.cc/4CSF-VT4T>] (last visited Apr. 12, 2017).

⁵² See, e.g., D’Arcy, *supra* note 40; *Increasing Number of Private Museums Stir Debate in Art World*, PHILANTHROPY NEWS DIG. (Apr. 8, 2008), <http://philanthropynewsdigest.org/news/increasing-number-of-private-museums-stir-debate-in-art-world> [<https://perma.cc/4RWF-R2GN>] [hereinafter PHILANTHROPY NEWS DIG.].

⁵³ Shnayerson, *supra* note 42.

⁵⁴ Andrew M. Goldstein, *Interview Magazine Owner Peter Brant on the New “Renaissance” in American Art*, ARTSPACE (Apr. 22, 2014), http://www.artspace.com/magazine/interviews_features/how_i_collect/how_i_collect_peter_brant-52192 [<https://perma.cc/W9UL-5GL4>].

lished museums, their growth signifies a major “power shift within the art world”⁵⁵

The “paradox is that even as traditional museums depend on these private collectors for loans and gifts, they can only show a fraction of the art that they borrow or receive as donations.”⁵⁶ The majority of public museums only display about five percent of their holdings at any given time, whereas the number for private museums hovers around ten percent.⁵⁷ One rationale for the growth of private museums is that donating to more established museums can be more difficult for collectors.⁵⁸ This sentiment is growing on a global scale, as more collectors have become frustrated with the institutional constraints of donating to public arts institutions.⁵⁹ Museums tend to be “selective about what they accept,” and the majority do not focus on collecting contemporary art, which many consider to be a riskier practice.⁶⁰ Donors are aware of the risk that these major museums may turn around and sell any donated art in order to stay competitive. Founding a private art exhibition space guarantees that the donor’s collection will be on display, and “level[s] the playing field between collectors and museum professionals”⁶¹ Many collectors wish to share their remarkable collections with the public, and are able to act in furtherance of the general public interest by creating their own innovative private museums within the nonprofit sector.⁶²

⁵⁵ Kino, *supra* note 48.

⁵⁶ D’Arcy, *supra* note 40.

⁵⁷ E.g., Michael O’Hare, *Capitalizing Art Museum Collections: Awkward for Museums but Good for Art and for Society* 2, 9 (Goldman Sch. Pub. Policy, Working Paper No. GSPP08-005, Nov. 2005); PHILANTHROPY NEWS DIG., *supra* note 52.

⁵⁸ See Cohen, *Writing Off the Warhol Next Door*, *supra* note 3.

⁵⁹ *Id.*

⁶⁰ *Id.*; see also Shnayerson, *supra* note 42.

⁶¹ Kino, *supra* note 48. For example, Eli Broad refused to donate a significant portion of his contemporary art collection to the Los Angeles County Museum of Art, including works by Jeff Koons, Ed Rusha, and Cindy Sherman, after the museum would not agree to keep most of the work on permanent exhibition. Broad instead founded his own private museum, which is now one of Los Angeles’ foremost cultural gems. DON THOMPSON, *THE \$12 MILLION STUFFED SHARK: THE CURIOUS ECONOMICS OF CONTEMPORARY ART* 219 (Palgrave MacMillan 2008); Cohen, *Writing Off the Warhol Next Door*, *supra* note 3.

⁶² Charla, *supra* note 36, at 163.

II. THE TAX-SAVVY CONNOISSEUR

“[I]f you were to walk up to the typical U.S. museum director and ask, ‘How are American museums funded?’ . . . [Y]ou would get a simple, straightforward answer: ‘Precariously.’”

– Ford W. Bell⁶³

In the United States, cultural development is furthered largely through the tax treatment of museums: The Code is structured to provide nonprofit organizations with a significant amount of leeway, and there is little regulation of the charitable sector.⁶⁴ A museum’s level of accountability is determined by its legal status, yet the Code has struggled to keep up with the development of private museums.⁶⁵ The current regulatory scheme reflects the view that “[e]verything about the substance of the tax law defines charity as fundamentally private. The tax law contemplates private creation, private governance, and private funding of exempt organizations.”⁶⁶ Despite the underlying private nature of the charitable sector, the rules governing private collection museums mirror those originally created to oversee “the legal status and management structure . . . [of their] public counterpart.”⁶⁷ Consequently, the systems in place to qualify for tax-exemption fail to take into account some of the unique organizational and management structures of private art museums as discussed in the following sections.⁶⁸

⁶³ Stacy Perman, *Billionaire Art Museums*, BARRON’S (Nov. 29, 2014, 2:41 AM), <http://www.barrons.com/articles/billionaire-art-museums-1417230557> [<https://perma.cc/VE22-4B4S>].

⁶⁴ See, e.g., Linda Sugin, *Rhetoric and Reality in the Tax Law of Charity*, 84 *FORDHAM L. REV.* 2607, 2614 (2016).

⁶⁵ Crawford, *supra* note 45, at 34.

⁶⁶ Sugin, *supra* note 64.

⁶⁷ See Crawford, *supra* note 45, at 34–35.

⁶⁸ See generally *id.* For example, “[t]he use of an art foundation to administer a collection affords individuals key benefits: tax deductions, tax exemptions, tax deferrals, and continued control. Accordingly, collectors are able to continue to enjoy and manage their collections while minimizing their overall tax liability.” Richard M. Horwood, *Being “Tax-Wise” When Managing an Art Collection*, 33 *J. TAX’N INV.*, no. 2, 2016, at 19, 28.

A. Charitable Deduction Limitations

The Code imposes several percentage limitations on the total amount of allowable deductions for charitable contributions made by a donor within the taxable year, either in cash or other property, or during a subsequent carryover year.⁶⁹ Charitable deductions vary based on the type of property donated, and the legal status of the organization.⁷⁰ Typically, an art collection is “capital gain property,” which tends to receive more favorable tax treatment.⁷¹ A donor is allowed a charitable contribution deduction for the donation of long-term capital gain property—assets that the donor held for more than one year, or property that appreciates in value—equal to the property’s fair market value (“FMV”).⁷² This allows donors to deduct the full value of an artwork at the time of the deduction, and benefit from any appreciation in value.⁷³ Section 501(c)(3) entities are divided into private foundations and public charities.⁷⁴ Generally, a donor may deduct up to fifty percent of their adjusted gross income (“AGI”) for an enumerated group of charitable contributions, including: churches, traditional educational institutions, hospitals and medical research, governmental units, and private foundations.⁷⁵ Public charities receive more favorable tax treatment than private foundations: They are limited to thirty percent AGI for capital gain property, and may deduct the FMV at the date of the gift; and are limited to fifty percent AGI of the donor’s contribution base for any gifts in the form of ordinary income property or cash.⁷⁶

A private foundation “does not itself carry on any charitable activities but rather receives funds from a limited number of do-

⁶⁹ I.R.C. § 170(b)(1) (2012).

⁷⁰ See generally § 170.

⁷¹ § 170(b)(1)(C)(iv).

⁷² See § 170(e); see also Treas. Reg. § 1.170A-8(d)(3) (2017). “The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts.” § 1.170A-1(c)(2).

⁷³ See, e.g., §§ 1.170A-8(d)(3), 1.170A-4(b)(2); INTERNAL REVENUE SERV., CHARITABLE CONTRIBUTIONS FOR USE IN PREPARING 2016 RETURNS, pub. 526, no. 15050A, at 11 (Jan. 19, 2017), <https://www.irs.gov/pub/irs-pdf/p526.pdf> [<https://perma.cc/CQ8F-KZ5U>].

⁷⁴ § 170(b)(1).

⁷⁵ § 170(b)(1)(A).

⁷⁶ See generally § 170(b)(1)(C).

nors—frequently a single wealthy individual—and then invests or distributes those funds to other 501(c)(3) organizations.”⁷⁷ Private foundations are subject to more stringent rules than public charities due to their sources of financial support, and the ability for donors to exert greater control over the organization.⁷⁸ For example, private foundations are limited to a twenty percent deduction of AGI for capital gain contributions made within the taxable year, with a five-year carry-forward period.⁷⁹ Still, private foundations create three major tax incentives for donors: (1) an income tax deduction for each taxable year during which the charitable contribution is made; (2) avoidance of capital gains taxes based on the property donated; and (3) a reduction, or possibly an elimination, of estate taxes.⁸⁰

B. Favorable Tax Treatment of Private Operating Foundations

Private foundations are divided into two types of organizations. The first of the two are nonoperating foundations, which generally provide support to charitable organizations through grants and other financial means.⁸¹ Nonoperating foundations are limited to the twenty percent charitable deduction of the taxpayer’s basis,⁸² and cannot deduct the FMV for donated artworks.⁸³ Most private museums fall under the second category as operating foundations, which are organizations that “directly” devote their assets or income to “the active conduct of the activities constituting” the charitable or educational purpose “for which it is organized and operated.”⁸⁴ Given the differences in “organizational management,”

⁷⁷ Michael Fricke, *The Case Against Income Tax for Nonprofits*, 89 ST. JOHN’S L. REV. 1129, 1178 (2015) (citing I.R.C. § 509 (2012)).

⁷⁸ INTERNAL REVENUE SERV., DOMESTIC PRIVATE FOUNDATIONS, TAX YEAR 2013, <https://www.irs.gov/pub/irs-soi/2013privatefoundationsonesheet.pdf> [<https://perma.cc/79LP-SGGC>] (last visited Apr. 13, 2017). See generally § 170(b)(1).

⁷⁹ § 170(b)(1)(D)(i)–(ii).

⁸⁰ *What Is a Private Foundation?*, FOUND. SOURCE, <https://www.foundationsource.com/learn-about-foundations/what-is-a-private-foundation/> [<https://perma.cc/G657-48VK>] (last visited Apr. 13, 2017).

⁸¹ INTERNAL REVENUE SERV., *supra* note 78.

⁸² See *supra* note 79 and accompanying text.

⁸³ § 170(b)(1)(D)(i).

⁸⁴ I.R.C. § 4942(j)(3)(A) (2012). “Substantially all” has been interpreted to mean an amount “equal[] [to] at least [eighty-five] percent of [the] foundation’s adjusted net income” Treas. Reg. § 53.4942(b)-1(c) (2017). For the purposes of section 4942(j),

taxpayers generally choose to form a private operating foundation, which are afforded greater tax deductions than other private grant-making foundations, and receive generous tax treatment similar to public charities.⁸⁵

Like public charities, private operating foundations are subject to the thirty percent and fifty percent deduction limitations.⁸⁶ Any charitable contribution of capital gain property is limited to thirty percent AGI of the taxpayer's contribution base for the taxable year, and may deduct the full FMV at the date of the gift.⁸⁷ A taxpayer may elect to increase the limit of the charitable contribution base to fifty percent AGI for the taxable year, but is not entitled to deduct the full FMV.⁸⁸ If the taxpayer chooses to make such an election, the amount of the deduction is limited to the taxable year in which the contribution was made.⁸⁹ Donors may carry over any deduction amount in excess for each of the following five years.⁹⁰ Additionally, a donor must transfer her entire interest in the property to the foundation, and cannot benefit from any interest that would increase the value of the property once donated.⁹¹ Operating foundations are far more beneficial to donors than private nonoperating foundations, who may deduct the full FMV of any property donated.⁹² The FMV deduction is particularly compelling for donors who wish to gift artworks that they have owned for a long time, and have significantly appreciated in value.⁹³ Creating a private mu-

"adjusted net income" is the excess of the gross income over the total amount of the deductions for the taxable year. § 4942(f)(1)(A)-(B).

⁸⁵ Compare *supra* text accompanying notes 78-79, 82-83, with *infra* text accompanying notes 86-93.

⁸⁶ See § 170(b)(1)(C); see also notes 75-76 and accompanying text.

⁸⁷ § 170(b)(1)(C)(i), (iv).

⁸⁸ § 170(b)(1)(C)(ii)-(iii), (d)(1)(A).

⁸⁹ § 170(b)(1)(C)(iii).

⁹⁰ See § 170(d)(1)(A). A donor may carry over any amount of charitable contributions that cannot be deducted during the current taxable year because they are in excess of the donor's AGI limits. *Id.*

⁹¹ Samuel G. Wiczorek, Winokur, *Lose, or Draw: Art Collectors Lose an Important Tax Break*, 8 HOUS. BUS. & TAX L. J. 90, 94 (2008) (citing I.R.C. § 170(f)(3)(A) (2006)).

⁹² See § 170(b)(1)(C).

⁹³ *Id.* For example, a donor owns a painting with a FMV of \$10,000 at the time of the donation, but only purchased the artwork for \$5,000 (the donor's basis). If the donor gifts the painting to a private operating foundation, then she is may deduct the full FMV. In comparison, if the donor were to gift the painting to a private nonoperating foundation,

seum also provides certain tax-saving advantages over donating to more established museums. Donors do not have to report as income any appreciation of value in the donated artworks, or any charitable contributions in the form of cash, subject to the fifty percent limitation.⁹⁴ Furthermore, any assets or property donated are not subject to estate tax if the donor wishes to bequeath these to a private operating foundation, in the event of his or her death.⁹⁵

An operating foundation must satisfy the income test, which requires that it make “substantial” qualifying distributions for its exempt purposes, equal to the lesser amount of either its adjusted net income or its minimum investment return.⁹⁶ Additionally, an operating foundation must satisfy either one of the following three alternative tests: the assets test, endowment test, or support test.⁹⁷ Private museums generally meet the requirements for the assets test, which mandates that “substantially more than half of the assets . . . are devoted directly to” its tax-exempt activities.⁹⁸ To qualify for the FMV deduction for a charitable contribution of an artwork, an organization must use such property in a manner related to its tax-exempt purpose under section 501(c)(3), or “to or for the use of a private foundation,” unless indicated otherwise in the Code.⁹⁹ An operating foundation must use the qualifying distribution itself, and must directly engage in activities that promote its charitable purpose.¹⁰⁰ Accordingly, a private museum cannot operate solely in a grant-making capacity, as this only helps other organizations achieve their charitable purposes rather than its own.¹⁰¹

then her charitable deduction is limited to \$5,000, and she cannot benefit from any appreciation in value. *See generally* § 170(b)(1).

⁹⁴ *See generally* I.R.C. §§ 170, 4942 (2012).

⁹⁵ Horwood, *supra* note 68, at 27.

⁹⁶ § 4942(j)(3)(A)(i)–(ii).

⁹⁷ *See generally* Treas. Reg. § 53.4942(b)-2 (2017). “Substantially more than half” has been interpreted to mean at least sixty-five percent of the organization’s assets. § 53.4942(b)-2(a)(5).

⁹⁸ § 4942(j)(3)(B)(i).

⁹⁹ § 170(e)(1)(B)(i)–(ii); Treas. Reg. § 1.170A-4(b)(3)(i) (2017); *see also* INTERNAL REVENUE SERV., ART GALLERIES – AUDIT TECHNIQUE GUIDE 21 (2012), <https://www.irs.gov/pub/irs-utl/artgalleries.pdf> [<https://perma.cc/7AWK-QXCG>].

¹⁰⁰ § 53.4942(b)-1(b)(1).

¹⁰¹ *See id.* “[I]f a foundation does no more than select, screen, and investigate applicants for grants or scholarships, pursuant to which the recipients perform their work or studies alone or exclusively under the direction of some other organization, such grants or

Certain expenditures that assist the donor's foundation in directly carrying out its tax-exempt purposes are considered to be qualifying distributions.¹⁰² Such qualifying distributions include the acquisition or maintenance of a museum's operating assets (i.e., purchasing artworks), administrative expenses, and operating funds set aside for special projects such as the acquisition, restoration, or construction of additional facilities.¹⁰³

III. THE PRIVATE BENEFIT DOCTRINE

"I think these types of deals do not follow the intent, even if they follow the letter, of the law They feed into the idea that the system is rigged toward the wealthy." – Rebecca Wilkins¹⁰⁴

To qualify for federal tax exemption, an organization must show that its overall charitable purpose serves the public good, as opposed to private interests; however, public benefit is a subjective standard left open to interpretation.¹⁰⁵ Section 501(c)(3) imposes certain non-distribution constraints, and prohibits tax-exempt organizations from providing private benefits to any individuals who are not the intended public beneficiaries.¹⁰⁶ The Code was envisaged to prevent private foundations from "subsidizing private transactions . . . with a charitable contribution income tax deduction to the foundation's donor."¹⁰⁷ Thus, founders of tax-exempt organizations should not engage in conduct in furtherance of their own self-interest that conflicts with the interests of the museum's intended charitable class.¹⁰⁸ Section III.A illustrates the key differ-

scholarships will not be treated as qualifying distributions made directly for the active conduct of the foundation's exempt activities." § 53.4942(b)-1(b)(2)(i).

¹⁰² § 53.4942(b)-1(b)(1).

¹⁰³ *Id.*

¹⁰⁴ Cohen, *Writing Off the Warhol Next Door*, *supra* note 3.

¹⁰⁵ See Fricke, *supra* note 77, at 1139 (discussing "a 1939 House Committee Report [which] states that the exemption is meant for those organizations that provide 'benefits resulting from the promotion of the general welfare'" (citing H.R. REP. NO. 75-1860, at 19 (1938))).

¹⁰⁶ See I.R.C. § 501(c)(3) (2012); *see also* Treas. Reg. § 1.501(c)(3)-1(c)(1)-(2) (2017).

¹⁰⁷ DAY PITNEY LLP, *RUNNING YOUR OWN CHARITY: LEGAL BASICS OF PRIVATE FOUNDATIONS* 5 (2013).

¹⁰⁸ See § 1.501(c)(3)-1(d); *see also* Fricke, *supra* note 77, at 1139.

ence between the private inurement and private benefit doctrines. Section III.B and Section III.C lay out the operational and organization tests, and qualitative and quantitative tests used to assess whether a private benefit is substantial enough to disqualify an organization's tax-exempt status.¹⁰⁹ Lastly, Section III.D recounts the findings from the recent Senate Finance Committee Inquiry into the extent that these private art museums afford their donor-founders private benefits, and illustrates the difficulty in assessing the public benefit requirement.

A. Private Inurement and Private Benefit Constraints

Private inurement is clearly defined in the Code: An organization may only qualify for tax-exemption if “no part of the net earnings of which inures to the benefit of any private shareholder or individual”¹¹⁰ Private inurement is characterized as a transaction involving the “diversion of charitable assets to an insider; in effect, it is an insider stealing from the charity.”¹¹¹ These type of transactions primarily occur when an insider is overcompensated for property given to the charitable organization or for services rendered, or the charitable organization is undercompensated for the economic value that the insider benefits from.¹¹² Conversely, the rules surrounding private benefit are less palpable. These provisions are derived from the private inurement limitation, and are “tucked away” in the Code.¹¹³ The Department of the Treasury regulations provide a more modern approach to the prohibition against private benefits, stating:

An organization is not . . . [qualified for exemption] unless it serves a public rather than a private interest. Thus, . . . it is necessary for an organization to

¹⁰⁹ See John D. Colombo, *Using Donations to Set the Boundaries of Charitable Tax Exemption*, NAT'L CTR. ON PHILANTHROPY & L. ANN. CONF. PROC. 1, 31 (2015) [hereinafter Colombo, *Using Donations*].

¹¹⁰ § 501(c)(3). “The words private shareholder or individual in section 501 refer to persons having a personal and private interest in the activities of the organization.” § 1.501(a)-1(c).

¹¹¹ Colombo, *Using Donations*, *supra* note 109, at 38.

¹¹² *Id.*

¹¹³ John, *supra* note 22, at 892 (citing Micah J. Burch, *National Funding for the Arts and the Internal Revenue Code §501(c)(3)*, 37 FLA. ST. U. L. REV. 303, 303 (2010)).

establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.¹¹⁴

Private benefit is more of a balancing test that considers the public and private interests at stake, and is evaluated on a case-by-case basis to determine whether the transaction involved contravenes the private benefit limitation under section 501(c)(3).¹¹⁵

There are two key distinctions that differentiate private benefit from private inurement. The first is that private inurement is a general rule that disqualifies an organization for even a single transaction that confers a private benefit, regardless of whether the organization's overall activities are in furtherance of its charitable purposes.¹¹⁶ With private benefit, a single transaction is not alone disqualifying.¹¹⁷ Rather, the private benefit restriction forbids transactions that serve more private interests than public.¹¹⁸ Second, private inurement focuses on "insiders" within the organization (i.e., officers or directors).¹¹⁹ Private benefit applies to any "disinterested persons" outside of the intended charitable class who receive benefits from the tax-exempt organization's activities, and is not only limited to insiders.¹²⁰ The definition of a disqualified person extends to any family member of an insider (i.e., a spouse, ancestor, child, grandchild, great grandchild, or the spouse of such qualifying individual's children, grandchildren, or great

¹¹⁴ § 1.501(c)(3)-1(d)(1)(ii); see also John D. Colombo, *In Search of Private Benefit*, 58 FLA. L. REV. 1063, 1067 (2006) [hereinafter Colombo, *In Search of Private Benefit*].

¹¹⁵ See Colombo, *In Search of Private Benefit*, *supra* note 114, at 1072-73.

¹¹⁶ *Id.* at 1083.

¹¹⁷ *Id.* at 1072-73.

¹¹⁸ *Id.*

¹¹⁹ See *id.* at 1073; Andrew Megosh et al., *Private Benefit Under I.R.C. 501(C)(3)*, in EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION TECHNICAL INSTRUCTION PROGRAM 135, 139 (2001), <https://www.irs.gov/pub/irs-tege/eotopich01.pdf> [<https://perma.cc/X3N3-7SUB>].

¹²⁰ Megosh et al., *supra* note 119. "Disqualified persons are 'insiders' - individuals and organizations that have, or are likely to have, a close relationship with a private foundation. Note that a corporation or other entity can be a disqualified person, despite the ordinary meaning of the term 'person.'" DAY PITNEY LLP, *supra* note 107.

grandchildren).¹²¹ In fact, the majority of private benefit cases involve some “entities or persons that have some relationship with the persons controlling the exempt organization.”¹²² To minimize risk, private museums should generally avoid transactions that favor disqualified persons as much as possible.¹²³

Private benefit extends beyond explicit financial transactions or stealing, and is as a result, generally more difficult to gauge.¹²⁴ The two doctrines come into conflict with one another in the context of private museums, where donor-founders or “insiders” often receive private benefits—either tangible or intangible.¹²⁵ Certain tax-saving strategies raise the issue of the perceived fairness of the Code, especially when wealthy donors are able to subsidize expensive art purchases.¹²⁶ Private operating foundations offer donors clear advantages over public charities, such as exclusive control over their art collections, how the foundation’s assets are managed, grant-making and programming decisions, and the overall governance structure.¹²⁷ For example, donor-founders can deduct any cash or stock assets contributed to a private operating foundation to cover the ordinary and necessary expenses in connection with the management, maintenance, or conservation of any property held by the organization.¹²⁸ These foundations “can write off the cost of conserving, caring for and insuring the art, as well as design-

¹²¹ I.R.C. § 4946(d) (2012).

¹²² Megosh et al., *supra* note 119.

¹²³ DAY PITNEY LLP, *supra* note 107; *see also* Colombo, *Using Donations*, *supra* note 109, at 32 (“[I]n any particular transaction between a charity and an actor outside the charitable class, they should ask themselves whether the transaction appears to be structured more toward enriching the outside actors than helping the charitable class; if the former, then alarm bells should ring loudly, although they [will not] really know if a problem exists without litigation.”).

¹²⁴ Megosh et al., *supra* note 119, at 138–39.

¹²⁵ *Id.* at 144. *See generally* NAT’L ASSEMBLY OF STATE ARTS AGENCIES, WHY SHOULD GOVERNMENT SUPPORT THE ARTS? 5–7 (2010), <http://www.culturalpolicies.net/web/files/83/en/US-WhyGovSupport2010.pdf> [<https://perma.cc/4H4N-FQ5W>].

¹²⁶ *See* Steven Rodgers, Comment, *Donate Your Art and Keep It Too: How the Government Subsidizes Art Collections for the Rich and What Congress Can Do About It*, 40 S. ILL. UNIV. L. J. 45, 47 (2015).

¹²⁷ *What Is a Private Foundation?*, *supra* note 80 (“When assets are contributed to a private foundation, they are excluded from the donor’s estate and, as a result, are not subject to either federal or state estate taxes.”).

¹²⁸ I.R.C. § 4942(f)(3)(A) (2012).

ing and building exhibition and storage facilities.”¹²⁹ Art foundations’ purchases of artworks are also exempt from “state and local sales taxes . . . , [thereby] reducing the overall cost borne by a collector for acquiring a new object.”¹³⁰ By founding private art museums, high-net-worth individuals can also avoid paying estate taxes, and simultaneously serve a charitable interest that contributes to their philanthropic legacy.¹³¹ Public opinion, though rife with misconceptions about museums and their finances, has gradually shifted toward questioning why such wealthy charitable organizations merit tax exemption.¹³² Consequently, private museums that do not conduct activities in furtherance of their charitable purpose—to benefit the general public—may warrant further investigation into their status as tax-exempt organizations.

B. Operational and Organizational Tests Require Private Operating Foundations’ Tax-Exempt Activities Serve Their Intended Beneficiaries Rather than Private Interests

In *American Campaign Academy v. Commissioner*, the Tax Court defined private benefit as “nonincidental benefits conferred on disinterested persons [that] serve private interests.”¹³³ Under section 501(c)(3), “an organization must be both organized and operated exclusively for one or more” exempt purposes,¹³⁴ and is not exempt if it fails to satisfy either test.¹³⁵ To satisfy the requirements, an organization must show “that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.”¹³⁶ Whether an organization’s activities serve private interests is a “factual determination” that requires the organization to show

¹²⁹ Cohen, *Writing Off the Warhol Next Door*, *supra* note 3.

¹³⁰ Horwood, *supra* note 68, at 27.

¹³¹ *Id.* at 25 (“In addition to an income tax deduction, as with noncharitable gifts, the collector receives the benefit of removing the artwork from his or her estate for estate tax purposes.”); *see also* *What Is a Private Foundation?*, *supra* note 80.

¹³² John, *supra* note 22, at 889.

¹³³ 92 T.C. 1053, 1069 (1989).

¹³⁴ Treas. Reg. § 1.501(c)(3)-1(a)(1) (2017).

¹³⁵ *Id.*

¹³⁶ § 1.501(c)(3)-1(d)(1)(ii).

that it “serves public rather than private interests.”¹³⁷ However, the Code is unclear on how much public benefit is necessary to warrant the enormous tax breaks afforded to wealthy art collectors.¹³⁸ Tax-exempt organizations are inherently private, and are afforded a fair amount of autonomy by the government.¹³⁹ In reality, it is incredibly difficult to identify when a private benefit becomes substantial enough to raise concern¹⁴⁰—essentially all charitable organizations conduct activities that confer some sort of private benefit.¹⁴¹

1. Organizational Test Considers a Private Museum’s “True” Purpose

To satisfy the organizational test, “the organizational documents must limit the mission of the organization to one or more exempt purposes; limit the organization’s power to engage in non-exempt activities[;] . . . and provide that the organization’s assets must be distributed for other related exempt purposes upon dissolution.”¹⁴² A private operating foundation should clearly define what audience it aims to serve, and how its resources are allocated.¹⁴³ Problems arise when the museum declares a number of charitable purposes that may be in conflict with one another.¹⁴⁴

¹³⁷ Megosh et al., *supra* note 119, at 135–36.

¹³⁸ See Cohen, *Tax Status of Museums Questioned by Senators*, *supra* note 15.

¹³⁹ See Sugin, *supra* note 64 (citing EVELYN BRODY & JOHN TYLER, *HOW PUBLIC IS PRIVATE PHILANTHROPY? SEPARATING REALITY FROM MYTH* (1st ed. 2009)). “[T]he law recognizes ‘the importance of philanthropic independence, respects philanthropies as private entities, and accord[s] them the right to autonomy without undue government or public direction and control.’” *Id.* (citing BRODY & TYLER, *supra*, at 11).

¹⁴⁰ See *id.* (“[T]he tax law contains no system for evaluating how well a public interest is served . . .”); accord Colombo, *Using Donations*, *supra* note 109, at 30 (“No one (including the IRS) can adequately define what it is or when it becomes a problem, for a simple reason: literally all the activities of a charity provide private benefit in some form, including directly to the charitable class and indirectly to a whole host of actors outside the charitable class as a result of actually serving the charitable class.”).

¹⁴¹ *Id.*

¹⁴² John, *supra* note 22, at 887 (quoting Andras Kosaras, Note, *Federal Income and State Property Tax Exemption of Commercialized Nonprofits: Should Profit-Seeking Art Museums Be Tax Exempt?*, 35 *NEW ENG. L. REV.* 115, 128–29 (2000)).

¹⁴³ See Megosh et al., *supra* note 119.

¹⁴⁴ Cf. *Mission and Institutional Planning*, AM. ALLIANCE MUSEUMS, <http://www.aamus.org/resources/ethics-standards-and-best-practices/mission-and-planning> [https://

Under the current tax regime, whether the institution actually provides a “clear public benefit” is subject to sole discretion of the individual in control.¹⁴⁵ Though the actual use of the charitable gift is within the donor’s broad discretion, the public trust is vested in that discretion, partly because of the organization’s self-proclaimed mission or charitable purpose.¹⁴⁶ The Tax Court will consider the tax-exempt “organization’s true purpose, not the stated purpose or the organizational language.”¹⁴⁷ Given the particularly challenging nature of this inquiry, “[t]he best guide is the actual result or operation of an organization’s activities.”¹⁴⁸ A private museum that conducts educational activities will not qualify for exemption if the true purpose “was to benefit private interests.”¹⁴⁹ Therefore, a private museum should only conduct activities consistent with its goals and public purpose.

Private operating foundations pose a unique challenge in satisfying the organizational test, as they are not expressly required to be open to the public.¹⁵⁰ The Code only stipulates that a tax-exempt organization’s mission provide a “public benefit.”¹⁵¹ Private operating foundations may conduct several types of tax-exempt activities such as: the “exhibition of an art collection in the foundation’s own museum,”¹⁵² lending artworks to other 501(c)(3) organizations, grant-making or payments to individual beneficiaries that directly relate to the organization’s exempt activities, or allow-

perma.cc/YJ2X-76GR] (last visited Apr. 13, 2017) (“A museum’s mission statement is the primary benchmark against which to evaluate . . . [its] performance.”).

¹⁴⁵ Cohen, *Writing Off the Warhol Next Door*, *supra* note 3.

¹⁴⁶ Bryce, *supra* note 29, at 114, 119.

¹⁴⁷ See Megosh et al., *supra* note 119, at 139.

¹⁴⁸ *Id.* at 140.

¹⁴⁹ See Megosh et al., *supra* note 119, at 140 (citing *Am. Campaign Acad. v. Comm’r*, 92 T.C. 1053 (1989)).

¹⁵⁰ For example, a tax-exempt organization “devoted to improving the public’s understanding of Renaissance art” meets the requirements under section 501(c)(3). Treas. Reg. § 53.4942(b)-2(a)(6), Ex. (4) (2017). Eighty percent of its assets are a collection of Renaissance paintings that the organization lends “to museums and schools for public display.” *Id.* Despite the fact that the organization “does not have a building in which it displays these paintings,” it still satisfies the assets test if “such paintings are devoted directly to the active conduct of activities constituting [its] exempt purpose.” *Id.*

¹⁵¹ *Id.*

¹⁵² Horwood, *supra* note 68, at 27.

ing researchers to access the collection.¹⁵³ Generally, “[e]xhibition and access are considered an essential component of most museums’ missions and will be among the primary reasons why a museum is considering the acquisition of an object for its collections.”¹⁵⁴ For private museums with the designated purpose of exhibiting the donor’s collection, the foundation determines how much access to provide to the public.¹⁵⁵ In some instances, a private museum interprets the tax-exempt purpose to exhibit as an inherent duty to safeguard and preserve the museums’ physical assets (such as the collection itself), rather than merely providing access to the general public.¹⁵⁶ For example, a private operating foundation may adopt “a traveling-collection approach, making the foundation’s artwork available to museums on loan,”¹⁵⁷ and still qualify as a tax-exempt organization. The underlying justification for tax exemption is undermined if the organization uses its charitable deductions in a manner inconsistent with its overall charitable purposes.¹⁵⁸ Consequently, a private operating foundation that exclusively lends artworks may fall short of the organizational test if its collection is inaccessible to the general public, except when on loan to other 501(c)(3) organizations.¹⁵⁹

¹⁵³ See generally § 53.4942(b)-1(b)(2)(i). The regulation provides an example: [Consider] S, a [tax-]exempt organization described in section 501(c)(3), [which] maintains a large library of manuscripts and other historical reference material relating to the history and development of the region in which the collection is located. S makes a limited number of annual grants to enable post-doctoral scholars and doctoral candidates to use its library. Sometimes S obtains the right to publish the scholar’s work, although this is not a prerequisite to the receipt of a grant. The primary criterion for selection of grant recipients is the usefulness of the library’s resources to the applicant’s field of study. Under these circumstances, the grants made by S constitute qualifying distributions made directly for the active conduct of S’s exempt activities.

§ 53.4942(b)-1(d), Ex. (7) (emphasis added).

¹⁵⁴ Gilboe, *supra* note 23.

¹⁵⁵ See Horwood, *supra* note 68, at 28.

¹⁵⁶ Gordon H. Marsh, *Governance of Non-Profit Organizations: An Appropriate Standard of Conduct for Trustees and Directors of Museums and Other Cultural Institutions*, 85 DICK. L. REV. 607, 610–11 (1981).

¹⁵⁷ Horwood, *supra* note 68, at 27.

¹⁵⁸ See Fricke, *supra* note 77, at 1161.

¹⁵⁹ *But cf. supra* note 150.

Private operating foundations perform an inimitable charitable function that is not serviced by other tax-exempt organizations.¹⁶⁰ These idiosyncratic institutions typically appeal to collectors of more avant-gardes artworks—founders have a greater degree of aesthetic control over the development of the museum's holdings, and as a cultural organization.¹⁶¹ Private museums generally abide by the founder's vision, except when the donor's intent is so rigid that it hinders the museum's long-term growth, or undercuts the public benefit.¹⁶² Consider the Barnes Foundation, which is one of the earliest private foundations in the United States.¹⁶³ Throughout the early twentieth century, business tycoon Albert C. Barnes assembled one of the most remarkable collections of post-Impressionist and modern paintings in the world, which is “worth between twenty to thirty billion dollars” today.¹⁶⁴ The Barnes Foundation has over 2,500 masterworks by artists including Paul Cézanne, Pierre-Auguste Renoir, Edgar Degas, Amedeo Modigliani, Vincent van Gogh, and Georges Seurat.¹⁶⁵ Notwithstanding the Barnes Foundation's status as one of the world's finest private museums, there was a time (early in his tenure of collecting) when Barnes' collection was predominantly unappreciated by the art world cognoscenti, and was often mocked by prominent Philadelphia arts institutions.¹⁶⁶ Driven largely by his passion for collecting—and to some degree his resentment of the cultural elite—Barnes erected his own private art museum in a mansion in Lower Merion, Pennsylvania, just outside of Philadelphia.¹⁶⁷ Barnes created the foundation to house his internationally renowned art

¹⁶⁰ Kino, *supra* note 48.

¹⁶¹ *Id.*

¹⁶² Shnayerson, *supra* note 42.

¹⁶³ Crawford, *supra* note 45, at 42.

¹⁶⁴ James Panero, *Outsmarting Albert Barnes*, PHILANTHROPY ROUNDTABLE (2011), http://www.philanthropyroundtable.org/topic/donor_intent/outsmarting_albert_barnes [<https://perma.cc/Z2LA-SZ3X>]. In comparison, the Bill & Melinda Gates Foundation was reported to have \$33.9 billion assets in 2009. *Id.*

¹⁶⁵ *Id.*

¹⁶⁶ *Id.*

¹⁶⁷ *Id.*

collection, and to develop educational programs to foster art appreciation among students.¹⁶⁸

Barnes was a forward-thinking visionary, but placed tight restrictions on the museum that hindered the foundation's existence as an independent organization.¹⁶⁹ He exerted tight control over the museum's operations and holdings, and meticulously curated the display of artworks himself.¹⁷⁰ The museum first opened its doors in 1925 as an art school, but furnished few opportunities for the public to visit until after Barnes' premature death in 1951.¹⁷¹ Barnes mandated that the collection stay in Lower Merion, and that the museum's holdings never be sold or loaned to other arts institutions.¹⁷² As a result, the Barnes Foundation was involved in a number of legal disputes that questioned whether its charitable activities provided a sufficient public benefit, in light of the limited public access to the collection.¹⁷³ Ultimately, the State Attorney General required the museum to remain open to the public two days a week, but allowed it to continue to operate by appointment only.¹⁷⁴ In subsequent litigation during the 1990s and 2000s, the courts disregarded the donor's original intent, and permitted the organization to increase its hours of operation and charge admission fees in order to raise the necessary capital to maintain its operations.¹⁷⁵ After a controversial board takeover and ensuing litigation over the museum's financial instability, the Barnes Foundation broke its independence and became affiliated with various Philadelphia-based foundations.¹⁷⁶ The museum's holdings were eventually transferred to the Barnes Foundation's new home in downtown Philadelphia, despite Barnes' mandate that he did not want the collection to change locations or merge with a public arts organization.¹⁷⁷

¹⁶⁸ *In re Barnes Found.*, No. 58,788, 2004 WL 2903655, at *12 (Pa. Ct. Com. Pl. Dec. 13, 2004).

¹⁶⁹ *See id.* at *13.

¹⁷⁰ *Id.*; accord D'Arcy, *supra* note 40.

¹⁷¹ Panero, *supra* note 164.

¹⁷² *See Barnes Found.*, 2004 WL 2903655, at *12-13; Panero, *supra* note 164.

¹⁷³ *E.g.*, *Barnes Found.*, 2004 WL 2903655, at *12-13.

¹⁷⁴ Panero, *supra* note 164.

¹⁷⁵ *See id.*; *see also Barnes Found.*, 2004 WL 2903655, at *1.

¹⁷⁶ *See* Panero, *supra* note 164.

¹⁷⁷ *See Barnes Found.*, 2004 WL 2903655, at *19; *see also* Panero, *supra* note 164.

This case demonstrates how a private museum must balance the donor's wishes with the organization's tax-exempt purposes, which may necessitate a greater amount of public access.¹⁷⁸ The museum's relocation to Philadelphia enabled the Barnes Foundation to provide greater public access, and safeguard Barnes' treasured collection for generations to come. Private museums "can become more firmly situated in the public realm" after the donor-founder's lifetime: Once artworks are donated to a private museum, they must remain in a tax-exempt organization.¹⁷⁹ Ultimately, the artworks in the collection are of paramount importance to the public benefit, not the donor's intent.¹⁸⁰

2. Operational Test: "Substantial" Private Benefits Threaten Tax-Exempt Status

Additionally, an organization must be "operated exclusively" in furtherance of one or more exempt purposes listed in section 501(c)(3).¹⁸¹ The operational test considers the foundation's "behavior and whether the organization seeking section 501(c)(3) status operates in a way that meets the exempt purposes listed in the Code."¹⁸² The organization must administer a significant enough public benefit to justify tax subsidies.¹⁸³ The operational test broadly "prohibit[s] a substantial nonexempt purpose . . . includ[ing] inurement, private benefit, and [any] operations that further non-

¹⁷⁸ See generally *Barnes Found.*, 2004 WL 2903655, at *1.

¹⁷⁹ Cohen, *Writing Off the Warhol Next Door*, *supra* note 3; see also *Barnes Found.*, 2004 WL 2903655, at *19 (noting that there "were signals that Dr. Barnes expected the collection to have much greater public exposure after his death"); *supra* text accompanying note 142.

¹⁸⁰ See *Barnes Found.*, 2004 WL 2903655, at *19.

¹⁸¹ Treas. Reg. § 1.501(c)(3)-1(c)(1) (2017). Note that the IRS has interpreted "exclusively" to mean "primarily." *Id.*

¹⁸² John, *supra* note 22, at 887 (citing Kosaras, *supra* note 142, at 129). "Although factors such as close control of the applicant, a proposed purchase from, financial transaction with, or management agreement with persons in control or related parties do not necessarily preclude exemption, they require adequate documentation and analysis to establish that the applicant operates for public rather than private purposes." Megosh et al., *supra* note 119, at 136. A donor's "close control . . . because of the potential for abuse, requires a clear demonstration that private interests will not be served." *Id.* (citing *Bubbling Well Church of Universal Love, Inc. v. Comm'r*, 74 T.C. 531 (1980), *aff'd*, 670 F.2d 104 (9th Cir. 1980)).

¹⁸³ See *infra* text accompanying note 235.

profit goals outside the scope of section 501(c)(3).”¹⁸⁴ Of the two prongs, the operational test is more difficult to examine when the private benefit is not financial or egregious.¹⁸⁵ The IRS guidelines vaguely address the type of situations where a nonprofit organization’s activities will threaten its tax-exempt status.¹⁸⁶ A determination of whether or not the benefit is substantial is central to the private benefit analysis.¹⁸⁷ Organizations that partake in activities that create too great of a private benefit (or nonexempt activity) risk the revocation of their tax-exempt status and penalties, although a single nonexempt activity can qualify for tax exemption if it relates to the organization’s tax-exempt purposes.¹⁸⁸ In these situations, “[t]he outcome depends on the weight assigned to various indicators of exempt versus nonexempt purpose[s].”¹⁸⁹

In addition to the public interests at stake, private museums often serve a “range of . . . special interests [that] reflect[] the scope of” the donor-founder’s vision.¹⁹⁰ For example, consider the Glenstone museum in Potomac, Maryland, which has raised questions over the potential imbalance of private benefits.¹⁹¹ The museum’s founders, Mitchell and Emily Rales, gained substantial tax benefits from the foundation, where they serve as the President/Director and President.¹⁹² The Rales donated at least \$450 million in stock

¹⁸⁴ See I.R.S. Priv. Ltr. Rul. 4036 (CG) (11–2005) 1, 6 (Jul. 12, 2011) (citing *Better Bus. Bureau v. United States*, 326 U.S. 279 (1945)).

¹⁸⁵ For a discussion of the challenges in assessing private benefits that are not merely financial transactions, see *supra* Section III.A.

¹⁸⁶ Peter Molk, *Reforming Nonprofit Exemption Requirements*, 17 FORDHAM J. CORP. & FIN. L. 475, 478 (2012).

¹⁸⁷ *Id.*

¹⁸⁸ Treas. Reg. § 1.501(c)(3)-1(e) (2017). “Bad museums, moreover, harm good museums by hoarding resources and diminishing the public’s general respect for museums.” Catherine A. Karayan, Note, *What Artworks May Come (To a Museum Near You): The State of Fractional Charitable Giving at the Intersection of Museology and Tax Policy*, 20 S. CAL. INTERDISC. L.J., 459, 474 (2011).

¹⁸⁹ *Overview of Inurement/Private Benefit Issues in IRC 501(C)(3)*, in EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION TECHNICAL INSTRUCTION PROGRAM (1990), <https://www.irs.gov/pub/irs-tege/eotopic90.pdf> [<https://perma.cc/WG8T-SJFV>] [hereinafter *Overview of Inurement/Private Benefit Issues*].

¹⁹⁰ *Code of Ethics for Museums*, *supra* note 9.

¹⁹¹ See generally Shnayerson, *supra* note 42.

¹⁹² See Form 990, No. 20-5938416, pt. VIII, Attachment 12 (2014), http://990s.foundationcenter.org/990pf_pdf_archive/205/205938416/205938416_201412_990PF.pdf?_ga=1.224798041.2120692051.1481836656 [<https://perma.cc/Q7HY-6C4Q>].

to Glenstone from 2012 to 2014, without paying capital gains tax.¹⁹³ Meanwhile, the museum benefits from tax-free stock that may be used to purchase artworks, invest in its expansion project, and/or cover operational expenses.¹⁹⁴ Despite the foundation's entanglement with private interests, Glenstone provides a number of public benefits that weigh in favor of tax exemption.¹⁹⁵ The foundation has made a concerted effort to serve its educational purposes by inviting children to view the contemporary art collection, which is valued at nearly one billion dollars.¹⁹⁶ Additionally, the Rales plan to construct a new building that will cost at least \$125 million,¹⁹⁷ and sought further "clarification from the IRS in 2012 to determine whether its expansion plan and land use were in accordance with the [Code]."¹⁹⁸ Regardless of the IRS' decision, the Rales are unlikely to "let taxes deter them. The couple have enough money and ambition to carry through with their plans even if the IRS were to" revoke the foundation's tax-exempt status.¹⁹⁹ The lofty project aims to attract more visitors, provide greater public access to Glenstone's art collection, and will likely eliminate any concern over private tax benefits.²⁰⁰

C. Qualitative and Quantitative Tests Fail to Define What Types of Private Benefits Cross the Threshold from Permissible Incidental Benefits to Impermissible Substantial Benefits

Generally, the presence of a substantial private benefit will disqualify an organization's tax-exempt status.²⁰¹ However, even substantial private benefits may be tolerated if they are considered qualitatively and quantitatively incidental in comparison with the

¹⁹³ Shnayerson, *supra* note 42.

¹⁹⁴ *Id.*

¹⁹⁵ For further examination of the Glenstone Foundation and substantial private benefit analysis, see *infra* Section V.C.

¹⁹⁶ Shnayerson, *supra* note 42; see also Form 990, *supra* note 192, at pt. II, Attachment 9.

¹⁹⁷ Shnayerson, *supra* note 42.

¹⁹⁸ See Halperin, *supra* note 44.

¹⁹⁹ Shnayerson, *supra* note 42.

²⁰⁰ See *id.*; see also discussion *infra* Section V.C.

²⁰¹ See Emily Chan, *Private Benefit Rules – Part I: Private Benefit Doctrine*, NONPROFIT L. BLOG (Sept. 27, 2012), <http://www.nonprofitlawblog.com/private-benefit-rules-part-i-private-benefit-doctrine/> [<https://perma.cc/MAK9-USZG>].

organization's charitable goals.²⁰² Qualitatively incidental private benefits are "a mere byproduct of a public benefit,"²⁰³ whereas, quantitatively private benefits should be insubstantial in amount.²⁰⁴ A qualitatively incidental "private benefit must not be substantial after considering the overall public benefit conferred by the activity."²⁰⁵ According to the IRS, some private benefit is *qualitatively* permissible if "the benefits from the organization's activities flow principally to the general public . . . [and] [a]ny private benefits derived . . . do not lessen the public benefits flowing from the organization's operations."²⁰⁶ Furthermore, the IRS ruled that "it would be impossible for the organization to accomplish its purposes without providing" some private benefit.²⁰⁷

To illustrate this point, consider the Brant Foundation, which received much scrutiny from the Senate Finance Committee Inquiry.²⁰⁸ Coupled with a number of concerns, including the lack of signage and the museum's relatively remote location, the Brant Foundation may run into private benefit issues for recording visits from "fellow billionaire collectors" in the organization's 2012 tax return as "among [its] charitable activities."²⁰⁹ The Brant Foundation does in fact provide public benefits such as "organiz[ing] traveling exhibitions, sponsor[ing] lectures and host[ing] educational

²⁰² *Overview of Inurement/Private Benefit Issues*, *supra* note 189; *see also* Plumstead Theatre Soc'y, Inc. v. Comm'r, 675 F.2d 244 (9th Cir. 1982). The Court of Appeals for the Ninth Circuit affirmed a decision by the Tax Court, holding that a 501(c)(3) arts organization's participation in a partnership with for-profit partners would not disqualify its tax-exempt status merely because some investors profited from the production of a play. *Id.* at 245. In this case, the private benefit was permissible because the investors participation was necessary for the organization to achieve its tax-exempt purpose. *See* Plumstead Theatre Soc'y, Inc. v. Comm'r, 74 T.C. 1324, 1330-34 (1980), *aff'd*, 675 F.2d 244 (9th Cir. 1982). The Ninth Circuit also found particularly relevant the fact that (1) the investors were "not shareholders in or officers or directors of" the organization; and (2) the agreement gave "full management" control over the operations to the organization, and not the investors. *Plumstead Theatre Soc'y*, 675 F.2d at 245; *accord* Chan, *supra* note 201.

²⁰³ Megosh et al., *supra* note 119, at 137.

²⁰⁴ Chan, *supra* note 201.

²⁰⁵ I.R.S. Gen. Couns. Mem. 39,598 (Jan. 23, 1987).

²⁰⁶ Megosh et al., *supra* note 119, at 137 (citing Rev. Rul. 70-186, 1970-1 C.B. 128).

²⁰⁷ *Id.* (citing Rev. Rul. 70-186, 1970-1 C.B. 128).

²⁰⁸ *See infra* text accompanying note 250.

²⁰⁹ Cohen, *Writing Off the Warhol Next Door*, *supra* note 3.

workshops for children;”²¹⁰ however, “[t]he identification of the art museum audience as an educational elite conflicts directly with the idea that museums provide a broad public benefit.”²¹¹ These incidental benefits are permissible so long as the organization’s tax-exempt activities benefit a broad enough charitable class.²¹² If exhibition and access are the primary charitable purpose, then the collection should be accessible to the general public, rather than serve a narrow class of wealthy beneficiaries.²¹³

A private benefit is *quantitatively* incidental if it is “a necessary concomitant of the activity which benefits the public at large, i.e., the activity can be accomplished only by benefiting certain private individuals.”²¹⁴ The inquiry considers the private benefit in relation “to the public benefit of the specific activity in question, not the public benefit provided by all [of] the organization’s activities.”²¹⁵ Even if the private benefit is substantial enough to question the organization’s tax-exempt status, it may be “unquantifiable . . . such as an advantage when dealing with the public.”²¹⁶ The more quantifiable the private benefit is, the greater the likelihood that the activity is non-incidental.²¹⁷ The presence of a private benefit is more likely when an organization deals primarily with a “single entity (or group of related entities), or . . . the group receiving the benefit is small.”²¹⁸

To determine whether a private benefit is either quantitatively permissible (i.e., incidental), or crosses the threshold to be considered substantial enough to undermine the organization’s tax-exempt status, consider the following two examples. A private art museum may be organized for the educational purpose of promot-

²¹⁰ *Id.*

²¹¹ SMITHSONIAN INST. OFFICE OF POLICY & ANALYSIS, *supra* note 9, at 7.

²¹² See Colombo, *In Search of Private Benefit*, *supra* note 115, at 1069.

²¹³ See Hubbard, *supra* note 25, at 29. Sam Keller, Director of the Fondation Beyeler, stated: “[A]rt is universal and for everybody However, our society has done a lot to make people insecure and not enough to educate them about it. Everyone can have an emotional experience and gain intellectual inspiration from a great work of art.” *Id.* at 29–30.

²¹⁴ I.R.S. Gen. Couns. Mem. 39,598 (Jan. 23, 1987).

²¹⁵ Megosh et al., *supra* note 119, at 137.

²¹⁶ Molk, *supra* note 186, at 487.

²¹⁷ Megosh et al., *supra* note 119, at 137.

²¹⁸ *Id.*

ing the arts, and exhibiting artworks by a group of lesser-known but accomplished local artists, yet still fall short of the operational test if it primarily serves private interests.²¹⁹ In the first scenario, a museum that provides a platform for artists to sell artwork and earn a significant portion of the profits, cannot qualify for tax exemption, despite its overall charitable purposes to provide support for local artists and ensure community engagement with the visual arts.²²⁰ For example, if the artists earn ninety percent and the museum keeps ten percent to cover its operating costs, the “principal activity . . . serves the private interests of these artists.”²²¹ This kind of arrangement is impermissible when the museum’s conduct provides direct private benefits that are non-incidental, and therefore, cannot be deemed as secondary to the organization’s tax-exempt purposes.²²²

In the second example, a private museum that conducts activities similar to those mentioned above may sell art and still qualify for exemption, only if its primary activity is related to its declared charitable purpose. In *Goldsboro Art League, Inc., v. Commissioner*, a museum sold and exhibited art by local artists who earned eighty percent of the profits, and retained twenty percent of the proceeds to cover its operating expenses.²²³ The Tax Court ruled that the museum was operated exclusively as an educational organization under section 501(c)(3),²²⁴ in part, because its primary activity was managing its art collection and promoting arts education to the general public.²²⁵ This type of private benefit is lawful, so long as the organization is not primarily dedicated to “a substantial commercial purpose.”²²⁶ The Tax Court identified several key factors that support tax exemption, including the museum’s mission to display “artist’s more daring works in a part of the country where

²¹⁹ See Treas. Reg. § 1.501(c)(3)-1(d)(1)(iii), Ex. (2) (2017).

²²⁰ *Id.*

²²¹ *Id.*

²²² *See id.*

²²³ See 75 T.C. 337, 340–41 (1980).

²²⁴ *Id.* at 344–46.

²²⁵ *Id.* at 344 (determining that the organization satisfied the public benefit requirement, in part, because “the overwhelming purpose of petitioner’s art classes, films, museum tours, and display of its permanent collection is charitable”).

²²⁶ *Id.* at 342.

there are no nearby art museums or galleries,” the organization’s “dedication to teach the public, through a variety of means, to appreciate art,” and the fact that the artists who received the private benefits were not in control.²²⁷ An activity that confers a substantial private benefit is permissible if: (1) it is “secondary and incidental,” and (2) furthers the organization’s primary tax-exempt purposes.²²⁸

D. Hatch Review Identifies Key Areas in the Tax Code Susceptible to Donor-Founder Abuse

The lack of clarity as to what qualifies as a non-incidental private benefit has raised concern among private collectors who must comply with these requirements.²²⁹ For the most part, these types of private benefits are qualitatively incidental, so long as they stem from a greater public benefit.²³⁰ However, the rules are less clear when assessing whether these benefits are quantitatively incidental, or how the substantial benefits tests should be applied to private art museums.²³¹ Many private benefits conferred on donors and founders of private museums are not directly quantifiable, despite their close ties to a single entity or individual.²³²

The current tax regime creates an imbalance in favor of wealthy individuals, and necessitates further review into how Congress can best address this unfairness in the Code.²³³ In May 2016, the U.S. Senate Finance Committee concluded its investigation into several private art museums to ensure that they satisfy the public benefit requirements under section 501(c)(3).²³⁴ The Inquiry considered several key elements to determine whether these private operating foundations confer substantial enough benefits to undermine the organization’s tax-exempt charitable purposes, including: the level of control the founder has over the museum’s assets and governance structure, the proximity of the location to the founder’s

²²⁷ *Id.* at 344–45.

²²⁸ *Id.* at 345.

²²⁹ *See supra* text accompanying note 205.

²³⁰ *See supra* text accompanying notes 204–07.

²³¹ *See* discussion *supra* Section III.C.

²³² *See supra* text accompanying note 216.

²³³ *See supra* text accompanying notes 126–32.

²³⁴ *See* Letter from Orrin G. Hatch to John Koskinen, *supra* note 12.

home, and the amount of public access to the museum's facilities.²³⁵ Senator Hatch admonished organizations that benefit their donor-founder at the expense of their charitable purpose.²³⁶ Though none of the factors alone justify the revocation of an organization's tax-exempt status, these may be informative when evaluating whether these private museums satisfy the qualitative and quantitative tests.²³⁷

1. Degree of Closeness to the Donor-Founder May Indicate Excessive Entanglement

One of the most significant factors is the source of the artworks in the collection.²³⁸ The Code is structured to incentivize these high-net-worth individuals to create privately funded operating foundations,²³⁹ and grants charitable tax deductions for artworks donated to private art museums created and controlled by the individual donor-founder.²⁴⁰ In practice, private operating foundations only separate the legal ownership of a donated artwork from the donor.²⁴¹ Given the tax law's failure to clearly establish the amount of donor control that renders a private museum ineligible for tax exemption, there is growing concern that some collectors will take advantage of these legal loopholes.²⁴² Of those surveyed, "[s]everal museums indicated that donors who had provided more than five percent of the collection . . . oversee [their] operations, often by serving as" a board member or "as President of the mu-

²³⁵ *E.g.*, Press Release, *supra* note 14.

²³⁶ Letter from Orrin G. Hatch to John Koskinen, *supra* note 12.

²³⁷ *See id.*

²³⁸ *Id.*

²³⁹ *See* I.R.C. § 4940(c)(3)(A) (2012).

²⁴⁰ Rodgers, *supra* note 126, at 46. "For those collectors who would like to partake in . . . charitable giving . . . , but are reluctant to cede over control over their collections to a wholly unrelated museum, the idea of establishing their own museum, with curators of their choosing might be a welcome one The challenge for such an arrangement is in determining when a donor's control over a museum renders the museum ineligible for tax-exempt status." Jason Kleinman & Michelle Bergeron Spell, *Tax Benefits and Challenges of Private Museums*, 20 *ART & ADVOCACY*, Summer 2015, at 4, <http://www.herrick.greatjakes.com/content/uploads/2016/03/Art-Advocacy-Summer-2015-Volume-20-v2.pdf> [<https://perma.cc/9K6Z-VLZW>].

²⁴¹ Rodgers, *supra* note 126, at 63.

²⁴² *See supra* text accompanying note 236.

seum”²⁴³ Additionally, there is ambiguity around donor access, and whether access to the museum after-hours is impermissible.²⁴⁴ Ultimately, Senator Hatch seemed distrustful of these type of relationships and cautioned against too much donor involvement.²⁴⁵

2. Congress Is Wary of Private Museums Situated Near a Donor-Founder's Residence

Another important factor is the location of the museum in relation to the donor's property. The IRS has previously determined that donors cannot deduct artworks situated in their private residence that are not primarily designated for public display.²⁴⁶ For example, the IRS revoked federal tax exemption for a public exhibition space located in the backyard of taxpayer's private residence near the swimming pool.²⁴⁷ An organization's tax-exempt status may also be in jeopardy if the foundation is in an inconvenient location that limits public access, and is a short walk from the donor's private residence.²⁴⁸ Senator Hatch specifically raised issue with the Brant Foundation Art Study Center in Greenwich, Connecticut, which “is just down the road from the . . . estate of its creator, Peter M. Brant, the newsprint magnate and avid art collector.”²⁴⁹ There are no signs identifying the building, and the Center is located on an unmarked street, “though the location is known to the

²⁴³ Letter from Orrin G. Hatch to John Koskinen, *supra* note 12.

²⁴⁴ *Id.* (“Several museums indicated that their directors, trustees, and donors have physical access to the museum outside of normal operating hours. Some of these personnel . . . [are] donors who provided a substantial portion of the museum's collection, or in some cases, established the museum. These museums uniformly asserted that such access was solely for purposes related to the museums' operations (such as changing exhibits, office work, etc.) and not for personal purposes.”).

²⁴⁵ *See id.*

²⁴⁶ *See generally* I.R.S. Priv. Ltr. Rul. 88-24-001 (Nov. 5, 1987).

²⁴⁷ *Id.* “The fact that no effort was made to advise the general public of the availability of the garden through publicity or signs on the premises, despite the fact that most people would be reluctant to enter private property, let alone wander around a private house and pool, indicates an attempt to control and limit the size and timing of groups visiting the property.” *Id.* (noting that visits by a few groups affiliated with a museum or school were not enough to justify the tax exemption).

²⁴⁸ For discussion of the amount of access private operating foundations should provide to satisfy the public benefit requirement, see generally *supra* Section III.B.

²⁴⁹ Cohen, *Writing Off the Warhol Next Door*, *supra* note 3.

art-world cognoscenti and celebrities who attend the twice-a-year gala openings”²⁵⁰ There is also concern over whether the Code should encourage donor-founders to develop art museums in urban rather than rural communities. Many of the museums surveyed, including the Brant Foundation, were located outside of major cities, which is fairly common practice within the private museum sector.²⁵¹ Art museums have played a major role in the economic diversification of their local communities, especially in smaller cities where they play a large role in local economic development²⁵² due to their ability to attract a large number of visitors—both foreign and domestic—and increase local tourism.²⁵³ While museums can have a tremendous impact on urban renewal and rural development efforts, “not all cultural institutions have fared as well.”²⁵⁴ In some cases, private museums have failed to realize their potential as “economic drivers.”²⁵⁵

3. Limited Public Access Warrants Further Investigation into Whether These Private Museums Fall Short of the Public Benefit Requirement

Additionally, the Inquiry examined the amount of access—or lack thereof—that these private operating foundations provide to the public.²⁵⁶ Private operating foundations are not expressly required to be open to the public to qualify as a tax-exempt organization under section 501(c)(3).²⁵⁷ On the other hand, private museums that do not actually exhibit art themselves, and only lend artworks, may be at odds with their tax-exempt purpose.²⁵⁸ In this instance, the private benefit of favorable tax treatment to the donor

²⁵⁰ *Id.*

²⁵¹ *See id.*; *see also* Press Release, *supra* note 14.

²⁵² Beatriz Plaza et al., *Culture-Led City Brands as Economic Engines: Theory and Empirics*, 54 *ANNALS REGIONAL SCI.* 179, 181–82 (2015).

²⁵³ *See id.* at 190.

²⁵⁴ *Id.* at 182 n.2.

²⁵⁵ *Id.* For example, both the Milwaukee Art Museum and the Los Angeles Museum of Contemporary Art fell short of their attendance number projections. *Id.*

²⁵⁶ Letter from Orrin G. Hatch to John Koskinen, *supra* note 12.

²⁵⁷ *See supra* Section II.B (discussing the rules governing private operating foundations).

²⁵⁸ *Cf.* discussion *infra* Section IV.B.1. *But see supra* note 150 (describing examples of private museums that meet the public benefit requirement by lending their private collection to other arts institutions for display).

may outweigh the greater public benefit and justify the revocation of the organization's tax-exempt status;²⁵⁹ whereas a lending program that supplements the display of a private collection is likely to support tax-exemption so long as the public benefit outweighs any private interests at stake.²⁶⁰

Senator Hatch also expressed some misgivings about organizations with infrequent hours of operation.²⁶¹ Senator Hatch considered limited hours of operation problematic, noting that the "total number of hours open each week ranged from 20 to 48 hours" in a fifty-two-week year.²⁶² Quite a few museums have highly irregular schedules (e.g., opening for a total of twenty-five hours per week, closing for new projects and construction, or closing for weeks or months at a time to install new exhibits).²⁶³ Moreover, the Committee seemed to take issue with museums that require visitors to schedule reservations in advance.²⁶⁴ However, it is fairly common practice for museums to rely on a reservation system, either exclu-

²⁵⁹ See *supra* text accompanying notes 150–58.

²⁶⁰ See generally Letter from Orrin G. Hatch to John Koskinen, *supra* note 12 (considering whether any of the museums created "robust loan programs that make their art available in museums worldwide"). A number of the museums surveyed participate in partnerships with other arts institutions to display artwork to better serve their overall mission. *Id.* For example, the Hall Art Foundation provides extensive information online regarding its loan program and images from its permanent collection. See *Collection*, HALL ART FOUND., <http://www.hallartfoundation.org/collection> [<https://perma.cc/5YWK-3JSZ>] (last visited Apr. 13, 2017); *Loan Program*, HALL ART FOUND., <http://www.hallartfoundation.org/loan-program/artists/a-g> [<https://perma.cc/2UYH-3MUL>] (last visited Apr. 13, 2017); see also *infra* note 263 and accompanying text (providing more information on the private foundation's admission policies).

²⁶¹ See Letter from Orrin G. Hatch to John Koskinen, *supra* note 12.

²⁶² *Id.* The Linda Pace Foundation in San Antonio, Texas, was found to only be open for twenty hours per week, along with four other museums. *Id.*; see also Claire Voon, *Tax Law Too Lax? IRS Receives Results of Private Museum Investigation*, HYPERALLERGIC (June 2, 2016), <http://hyperallergic.com/303139/tax-law-too-lax-irs-receives-results-of-private-museum-investigation/> [<https://perma.cc/8RBE-DYS2>].

²⁶³ Letter from Orrin G. Hatch to John Koskinen, *supra* note 12. Notably, the Hall Art Foundation, a private operating foundation in Vermont, is considered "the least welcoming for a spontaneous museum trip." Voon, *supra* note 262. The Hall Foundation is open seasonally from May to November, on weekends and Wednesdays, and only offers appointments at 11 AM, 1 PM, and 3 PM. *About*, Section of *Vermont*, Subsection of *Locations*, HALL ART FOUND., <http://www.hallartfoundation.org/location/vermont> [<https://perma.cc/3TFC-RZJ5>] (last visited Apr. 13, 2017).

²⁶⁴ See Letter from Orrin G. Hatch to John Koskinen, *supra* note 12.

sively or extensively.²⁶⁵ Some require reservations weeks or even months in advance due to high demand.²⁶⁶ One of the museums surveyed explained, “[t]he reservation system is offered both as a convenience to visitors and as a means of managing visitor flow to offer an opportunity for a contemplative visit where each guest can connect directly with the art.”²⁶⁷ Other considerations include the number of visitors, the cost of admission, and alternative methods of public access to the collection.²⁶⁸ The Committee looked favorably upon museums that have steadily increased their number of visitors, and condoned others for their exceptionally low attendance records.²⁶⁹ Nearly all of the museums surveyed offer free admission, though Hatch acknowledged that institutional constraints may prevent some private museums from offering free entry.²⁷⁰

IV. PROPOSALS FOR REFORM

“The philanthropist puts art into the public purview, teaches, refines, and improves society . . . [P]hilanthropy [is] a [powerful] branding tool, conferring image, taste, and social responsibility . . . [The donor’s] ‘brand’ is defined and supplemented by adding their personal cultural assets to the public domain . . . the collector has deemed worth of his/her collection.”²⁷¹

The results of Senator Hatch’s investigation highlight the need to “[rein] in the out-of-control accumulation of wealth by the largest nonprofits yet keep in place all of the benefits enjoyed by those nonprofits that use their funds diligently for the betterment of society.”²⁷² Private museums are invaluable charitable organiza-

²⁶⁵ *Id.*

²⁶⁶ *Id.*

²⁶⁷ *Id.*

²⁶⁸ *See id.*

²⁶⁹ *Id.* “[T]he average number of visitors for the past five years was 5,700 or less, and some of the larger institutions welcome nearly half a million visitors annually.” *Id.*; *see also* discussion *infra* Section V.C; *cf.* discussion *supra* Section III.B.2.

²⁷⁰ *See* Letter from Orrin G. Hatch to John Koskinen, *supra* note 12.

²⁷¹ Weaver, *supra* note 2.

²⁷² Fricke, *supra* note 77, at 1162.

tions—they afford meaningful contributions in service of the public benefit that cannot be provided by other arts institutions.²⁷³ Collectors are worried that the Senate Inquiry will have a “chilling effect” on donors considering setting up their own private museums, or that it will lead to tighter restrictions that will prevent private art foundations from qualifying for tax-exempt status.²⁷⁴ On the other hand, those in the art world who support the Committee review share a more altruistic view of charitable deductions: These individuals believe donors should abide by the rules, and that “the scrutiny will simply weed out the bad apples.”²⁷⁵ This Part further examines the types of private benefits provided to donor founders, in order to determine their potential impact on the art world, and the increased risk—if any—that these foundations and their donors will be the subject of intense scrutiny. Section IV.A contends that the Code should continue to incentivize participation by high-net-worth individuals in the private art museum sector. Section IV.B asserts that, while there should be some level of reform, the IRS should not set aside the current tax exemption structure altogether. This Section demonstrates that private benefit should still be assessed on a case-by-case analysis, and proposes new guidelines to help these private museums comply with the public benefit limitations.

A. Tax Incentives Encourage Wealthy Individuals to Participate in the Private Museum Sector

One proposal to curb donor abuse is to limit charitable deductions to a lower percentage for private operating foundations with the donor-founder in control.²⁷⁶ However, this approach may remove some of the major incentives that led wealthy art patrons to create these museums in the first place. The current tax regime encourages billionaires to spend more money on art, and the private

²⁷³ See *supra* notes 160–62 and accompanying text.

²⁷⁴ See Halperin, *supra* note 44.

²⁷⁵ *Id.*; see also Cohen, *Writing Off the Warhol Next Door*, *supra* note 3 (“Howard Rachofsky and Vernon Faulconer, two Dallas collectors, and Rosa and Carlos de la Cruz, who is chairman of the CC1 Companies, in Miami, have opened small museums with limited hours and access, but neither gallery space is registered as a foundation or charity.”).

²⁷⁶ Rodgers, *supra* note 126, at 66.

museums spaces in which it is displayed, than they ordinarily would as individual collectors.²⁷⁷ Alternatively, limiting deductions may not have a significant deterrent effect—the wealthiest individuals will continue to build private collections regardless of the limitations on charitable deductions.²⁷⁸ The cost of establishing a private museum “is rarely offset in full by tax breaks. But those breaks do help.”²⁷⁹ Despite these issues, many individuals in the art world would keep the current tax subsidy structure for the sake of the overall benefits to the charitable sector.²⁸⁰ According to Jeffrey Deitch, the former Director of the Museum of Contemporary Art in Los Angeles, California, “[p]rivate museums are a ‘part of our American art culture,’ [and] . . . their recent burst of growth [is] ‘one of the most exciting developments in the international art world.’”²⁸¹

Any changes in the Code should avoid “unintended incentives, such as when the development of fractional giving fostered what Congress thought of as unfair tax practices.”²⁸² Fractional charitable giving is a tax savings strategy that “allows a donor to make a series of partial donations over an extended period of time . . . [and] is a particularly useful tool for donors who” desire a charitable deduction, but “do not wish to completely part with the donated

²⁷⁷ Shnayerson, *supra* note 42. There has been a fundamental shift in the way that high net-worth individuals collect: The “widespread belief that art” is one of the most stable and valuable assets has attracted many new art patrons, who regard art as an investment over its aesthetic value. See THOMPSON, *supra* note 61, at 230–32, 35; see also Susan E. Wagner, Note, *The Implications of Changing the Current Law on Charitable Deductions—Maintaining Incentives for Donating Art to Museums*, 47 OHIO ST. L. J. 773, 775 (1986). “[T]he contemporary art market has become a competitive high stakes-game, fueled by great amounts of money and ego.” THOMPSON, *supra* note 61, at 228. The market is driven by the behavior of these billionaire “supercollectors, whose fortunes originated in finance and hedge funds.” *Id.* at 232.

²⁷⁸ See *supra* note 199 and accompanying text.

²⁷⁹ Shnayerson, *supra* note 42.

²⁸⁰ See Cohen, *Writing Off the Warhol Next Door*, *supra* note 3. Maryse Brand, Director of the Hall Art Foundation, noted that these private museums “all have a common goal of making artwork available for the enjoyment and education of the public,” which “far outweigh[s] any benefits received from tax exemptions.” *Id.*

²⁸¹ *Id.*

²⁸² Sean Conley, *Paint a New Picture: The Artist-Museum Partnership Act and the Opening of New Markets for Charitable Giving*, 20 DEPAUL J. ART TECH. & INTELL. PROP. L. 89, 107 (2009).

[artwork].”²⁸³ A collector could gift only “a fraction of [the] full interest in a work of art to a museum” and in exchange, could deduct an amount equal to the full value of the art multiplied by the portion donated.²⁸⁴ Donors could dodge capital gains taxes on highly appreciated works of art.²⁸⁵ Collectors often held onto their artworks for decades before transferring full ownership to a museum, and were incentivized to delay giving over a longer time period due to the appreciation in value.²⁸⁶ Congress also expressed concern over museums’ close business ties with trustees and their related companies—a sentiment that is still expressed today among those who have called for a closer examination of tax incentives for high-income individuals in the private museum sector.²⁸⁷

In response, Congress enacted the Pension Protection Act of 2006, which effectively eliminated this loophole.²⁸⁸ The Act imposed two affirmative requirements: (1) the donor must donate the entire property interest within ten years from the initial fractional contribution date, or the death of the donor, whichever is the earli-

²⁸³ Karayan, *supra* note 188, at 460 (“[Fractional charitable giving] would, for example, allow a donor to give [ten percent] of a piece of art to a museum each year over ten years.”). *See generally supra* Section II.B (discussing charitable deductions for private operating foundations); *supra* Section III.A (discussing private benefits unique to these type of tax-exempt organizations).

²⁸⁴ Alicia C. Beyer, Note, *Gone but Not Forgotten: The End of Fractional Giving and the Search for Alternatives*, 36 COLUM. J.L. & ARTS 459, 460 (2013). In these instances, the donor only transfers a fractional interest of the artwork, and the museum is only “entitled to use and display the work for the amount of time corresponding to its fraction of ownership.” *Id.* A contribution would be calculated “[a]t the time of the initial donation[,]” and is equal to “the percentage interest in the work donated multiplied by the total value of the work.” *Id.* at 462.

²⁸⁵ Wieczorek, *supra* note 91, at 99. Before Congress put an end to fractional giving in 2006, “some of the country’s largest and most prestigious museums relied very heavily on fractional giving as a source of donations.” Beyer, *supra* note 284, at 461. “The San Francisco Museum of Modern Art (SFMOMA), which received the most fractional donations of any art museum, has more than eight hundred works in its permanent collection that started as fractional gifts.” *Id.*; *see also* Rachel Emma Silverman, *Joint Custody for Your Monet*, WALL ST. J. (July 6, 2005, 12:01 AM), <http://www.wsj.com/articles/SB112060578625677881> [<https://perma.cc/BN3T-ZUVX>].

²⁸⁶ Stephanie Strom, *The Man Museums Love to Hate*, N.Y. TIMES (Dec. 10, 2006), <http://www.nytimes.com/2006/12/10/arts/design/10stro.html?pagewanted=all> [<https://perma.cc/VJ2Y-TFEG>].

²⁸⁷ *Id.*; *see also* Letter from Orrin G. Hatch to John Koskinen, *supra* note 12.

²⁸⁸ Wieczorek, *supra* note 91, at 91.

est (“the gifting period”);²⁸⁹ and (2) transfer substantial physical possession of such property sometime during the gifting period, or the organization must use the property in a manner related to its tax-exempt purpose.²⁹⁰ Congress often responds to these “perverse incentives” by eliminating them altogether, “rather than dealing directly with the offending action.”²⁹¹ As a result, changes in the Code are not always as effective of a deterrent as Congress originally intended.²⁹² For instance, in the absence of fractional giving, wealthy donors began to form private operating foundations, the closest alternative that would allow donors to have some degree of control over their art collections, while still receiving tax breaks.²⁹³ Taxpayers that tend to skirt tax laws will alter their economic behavior in response to any alterations in the tax regime.²⁹⁴ To prevent the creation of similar inequities in the Code, any changes should “be aimed at those who essentially write-off their own collections while keeping tight control and limiting the public’s access.”²⁹⁵

B. Don’t Throw the Baby Out with the Bath Water!

If updated, the Code ought to reflect the public trust vested in donors, and their organizations, to fulfill their charitable purpose.²⁹⁶ Tax-exempt organizations “principal responsibility . . . is to strengthen that trust and to restore it if it is impaired by their policies, decisions, actions, omissions, or under their supervision.”²⁹⁷ The aim should be to provide the nonprofit private museum sector with a certain degree of autonomy to ensure its survival.²⁹⁸ The current regime for tax-exemption “indicates that Con-

²⁸⁹ Pension Protection Act of 2006 § 1218 (a)(3)(A)(i)(I)-(II), I.R.C. § 170(o)(3)(A) (2012).

²⁹⁰ See, e.g., Pension Protection Act § 1218 (a)(3)(A)(ii)(I)-(II).

²⁹¹ Conley, *supra* note 282, at 107.

²⁹² See *id.* at 107-08.

²⁹³ See *id.* at 107.

²⁹⁴ *Id.*

²⁹⁵ Rodgers, *supra* note 126, at 61.

²⁹⁶ See Bryce, *supra* note 29, at 128.

²⁹⁷ *Id.* at 128-29.

²⁹⁸ Fricke, *supra* note 77, at 1166 (explaining that “an effective solution . . . must be narrowly tailored to address the issue[,] . . . should respect the autonomy of all organizations[,] . . . [and] must actually address the problem”).

gress did not intend to exert much control over charitable organizations, since a deduction-based subsidy fosters the private control of charitable organizations.”²⁹⁹

Reform should also ensure that any artworks placed into these section 501(c)(3) organizations “see [their] way into the public realm.”³⁰⁰ For example, the Noguchi Museum in Long Island City, Queens, New York, was established by the “internationally renowned, Japanese-American artist Isamu Noguchi,” to house some of his most representative artworks.³⁰¹ Since its inception in 1985, the Museum was a program of the artists’ private operating foundation, and helped “pioneer . . . the metamorphosis of the Long Island City area into the arts district it is today.”³⁰² After twenty years, the Museum eventually consolidated with the Noguchi Foundation, and received public charity status in 2005.³⁰³ With enough time, successful private art museums, such as the Noguchi Museum and the Barnes Foundation, eventually turn into public charities, or develop into fully functional private arts institutions.³⁰⁴

Modification of the Code affects some organizations more than others, especially tax-exempt organizations that receive support by high-income individuals such as arts groups and educational institutions.³⁰⁵ These institutions rely heavily on the generosity of these individuals, hence more stringent regulations are not in the public

²⁹⁹ Sugin, *supra* note 64, at 2615. Congress clearly distinguished private operating foundations from public charities when it enacted the Tax Reform Act of 1969, and created more stringent rules for these institutions. Fricke, *supra* note 77, at 1138–39 (citing Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487, 496–98). Notably, there has not been any significant action since passing the Act. *Id.* “For the past forty-six years, the tax code as it pertains to nonprofits has been remarkably static.” *Id.*

³⁰⁰ Rodgers, *supra* note 126, at 57.

³⁰¹ *History*, NOGUCHI MUSEUM, <http://www.noguchi.org/museum/history> [<https://perma.cc/G2Z6-M59U>] (last visited Apr. 13, 2017).

³⁰² *Id.*

³⁰³ *Id.*

³⁰⁴ See discussion *supra* Section III.B.1.

³⁰⁵ See NAT’L ASSEMBLY OF STATE ARTS AGENCIES, *supra* note 125, at 4. “Undoubtedly, constituents of a group that has enjoyed a benefit for over 100 years will be highly resistant to any change in that benefit that could be construed as a lessening of the subsidy provided to them.” Fricke, *supra* note 77, at 1177.

interest.³⁰⁶ Any new rules should be narrowly tailored to prevent individuals from receiving substantial private benefits from charitable deductions.³⁰⁷ Reform should avoid adversely affecting organizations that provide publicly accessible educational programs and benefits.³⁰⁸ It is unrealistic to expect that wealthy donors will act on purely philanthropic motives: Collectors may partake in charitable giving to further their own self-interests, yet still contribute meaningful public benefits.³⁰⁹ For one, the act of cultivating a museum-quality private art collection is inextricably connected with the collector's ego.³¹⁰ It is human nature to desire recognition, and "[v]anity can be as strong a motivation as generosity."³¹¹ Wealthy art collectors usually expect for their art to be viewed by their peers and the general public.³¹² According to Allan Schwartzman, an art adviser for the Rachofsky House in Dallas, Texas, "[a]rt collecting becomes an expression of self."³¹³ Or as Marc Glimcher, President of New York gallery PaceWildenstein, explained: "[It is] the world's most expensive MySpace."³¹⁴

³⁰⁶ Marsh, *supra* note 156, at 623; *see also* Mary Varson Cromer, Note, *Don't Give Me That!: Tax Valuation of Gifts to Art Museums*, 63 WASH. & LEE L. REV. 777, 792 n.115 (2006) (citing *Bob Jones Univ. v. United States*, 461 U.S. 574, 587). "Given that the primary purpose of these provisions is to benefit charity, any benefit to the taxpayer is [essentially] secondary and merely for the purpose of providing incentive to the taxpayer to assist with the greater goal of benefiting charities. *Id.* at 793.

³⁰⁷ Rodgers, *supra* note 126, at 61.

³⁰⁸ *Id.* "In many of these instances where a small percentage of individuals are abusing an otherwise successful system, the argument is that any new legislation would be 'an overreaction to a limited problem.'" *Id.* (citing Vada Waters Lindsey, *The Charitable Contribution Deduction: A Historical Review and a Look to the Future*, 81 NEB. L. REV. 1056, 1079 (2003)).

³⁰⁹ Goldstein, *supra* note 54. Peter Brant, founder of the Brant Foundation, stated:
 [S]omebody can come in because they are commercially interested and think they can make a good living professionally off of art or just make a quick dollar and everybody hates that, but I don't hate it because those people can turn out to be the biggest collectors in the future, and those people can turn out to be the biggest sponsors of museum shows in the future.

Id.

³¹⁰ Kino, *supra* note 48.

³¹¹ D'Arcy, *supra* note 40.

³¹² Kino, *supra* note 48.

³¹³ *Id.*

³¹⁴ *Id.*

Collectors assert that the public benefits outweigh any private benefits, even in the case of the smaller museums with fewer numbers of visitors.³¹⁵ The tax system must still incentivize charitable giving, which, in some part, will always benefit collectors despite the organization's overall charitable purposes.³¹⁶ However, the tax law should not effectuate the private whims of these high-net-worth donors, if they contravene these idiosyncratic museums' ability to transition into fully functional institutions.³¹⁷ Museums can exist in perpetuity, therefore, the Code should not foreclose on future donors because "it all trickles down to build a much higher form of culture."³¹⁸ In all, it is more beneficial to grant these private museums tax-exemption because of the potential loss of important donors and supporters that museums tend to rely on the most.³¹⁹

1. Any New IRS Guidelines Should Prevent Exploitation of the Tax Regime

Rather than create an entirely separate tax regime to govern private operating foundations, the IRS should keep the current tax system in place, and issue new Treasury regulations or guidelines to ensure compliance with the public benefit requirement. Tax reform that revokes exemptions for museums undermines "the national promotion of educational programming in the humanities and the protection of priceless collections."³²⁰ Proposals to remove or significantly limit charitable deductions adopt a short-sighted view of the pedagogical role of private museums, and may thwart their ability to become influential cultural institutions. The Code should still incentivize private creation within the nonprofit arts industry because it is more beneficial to allow these organizations

³¹⁵ See Cohen, *Writing Off the Warhol Next Door*, *supra* note 3.

³¹⁶ See David Kocieniewski, *A Family's Billions, Artfully Sheltered*, N.Y. TIMES (Nov. 26, 2011), http://www.nytimes.com/2011/11/27/business/estee-lauder-heirs-tax-strategies-typify-advantages-for-wealthy.html?pagewanted=all&_r=0 [https://perma.cc/2PF6-T79V].

³¹⁷ See generally *supra* Section III.B.1 (discussing the Barnes Foundation, and the circumstances in which the courts may disregard the founder's original intent to uphold the organization's charitable purposes above all else).

³¹⁸ Goldstein, *supra* note 54 (quoting Peter Brant, founder of the Brant Foundation).

³¹⁹ See generally Marsh, *supra* note 156, at 623–24.

³²⁰ John, *supra* note 22, at 892 (citing Burch, *supra* note 113, at 306).

to continue to operate independently. The IRS should avoid creating over-prescriptive rules that would hinder the success of these organizations.³²¹ The private benefit analysis should be judged based on the totality of the circumstances. Any new regulations should give donors credit for investing in the private art museum sector, and allow them to write off expenses related to the museum's maintenance and operations, so long as these tax breaks benefit the general public.³²²

Public benefit is of paramount importance: a museum's governance, maintenance of its collection, and programmatic efforts must all abide by the organization's mission to serve the public and educate society "by advancing understanding and appreciation of" art.³²³ Donor-founders and those managing the museum's operations "must do more than avoid legal liability, they must take affirmative steps to maintain their integrity" and act ethically to justify their tax-exempt status.³²⁴ Private museums must act in furtherance of their declared charitable purposes to warrant tax exemption.³²⁵ Therefore, the Code should encourage private museums to do more to ensure public engagement beyond a narrow subset of their own community.³²⁶ At a bare minimum, private museums ought to be open to the public.³²⁷ Private arts institutions that merely lend artworks to other 501(c)(3) organizations without actually displaying their own collection should not qualify for tax-exempt status as a private operating foundation.³²⁸ The current tax regime allows these type of organizations to receive greater charitable deductions without contributing any tangible public benefits.³²⁹ Donors should not be entitled to more favorable tax treat-

³²¹ For historical background on fractional giving, see generally *supra* Section IV.A.

³²² See Cohen, *Writing Off the Warhol Next Door*, *supra* note 3.

³²³ *Code of Ethics for Museums*, *supra* note 9.

³²⁴ *Id.*

³²⁵ Bryce, *supra* note 29, at 114.

³²⁶ SMITHSONIAN INST. OFFICE OF POLICY & ANALYSIS, *supra* note 9, at 6.

³²⁷ *Eligibility Criteria*, AM. ALLIANCE MUSEUMS (Jan. 1, 2005) <http://www.aam-us.org/resources/assessment-programs/accreditation/eligibility> [<https://perma.cc/QBD2-43PT>].

³²⁸ See generally *supra* Section III.B (discussing the requirements for private operating foundations that satisfy the public benefit organizational and operational requirements for tax-exempt status, despite the lack of public access to their art collection).

³²⁹ See *supra* Part III.

ment for simply creating a separate entity as a conduit to lend art.³³⁰

Due to the limited legal guidelines for private museums, standard museum best practices are informative in determining whether an organization meets the requisite public benefit requirement.³³¹ The American Alliance of Museums (the "AAM") revised its official definition of a museum "to insist only on the use of objects, not on their ownership."³³² Any new regulations should adopt a similar view as the AAM "Eligibility Criteria," which requires its member museums to "function[] primarily at a physical facility/site[,] . . . be open to the public at least 1,000 hours a year[,] . . . and have at least one paid professional staff with museum knowledge and experience."³³³ In light of the various challenges in operating a private museum—both financially and managerially³³⁴—the IRS should avoid imposing too high of a standard on these institutions. Based on Senator Hatch's findings, the AAM requirements seem relatively fair when applied to both larger and smaller private art museums.³³⁵ Additionally, any physical facility used to store or display

³³⁰ See *supra* text accompanying notes 239–42.

³³¹ See *Code of Ethics for Museums*, *supra* note 9.

³³² SMITHSONIAN INST. OFFICE OF POLICY & ANALYSIS, *supra* note 9, at 1. The AAM aims to "enhance[e] the ability of museums to serve the public interest . . ." *Id.* at 7.

³³³ *Eligibility Criteria*, *supra* note 327. A museum, by definition must meet the following requirements:

[1] be a legally organized not-for-profit institution or part of a nonprofit organization or government entity[;] [2] be essentially educational in nature[;] [3] have a formally stated mission[;] [4] use and interpret objects and/or a site for the presentation of regularly scheduled programs and exhibits[;] [5] have a formal and appropriate program of documentation, care, and use of collections and/or tangible objects . . . [;] [6] have at least one paid professional staff [member] with museum knowledge and experience[;] [7] have a full-time director to whom authority is delegated for day-to-day-operations[; and] [7] have the financial resources sufficient to operate effectively.

Id.

³³⁴ See *supra* text accompanying note 53.

³³⁵ Senator Hatch observed that the lower end of the spectrum for weekly hours of operation is about twenty hours per week and equals slightly more than 1,000 hours total in a fifty-two-week year. Letter from Orrin G. Hatch to John Koskinen, *supra* note 12. "A number of the museums indicated that in addition to being open to the public, they also accommodated school groups and other private visitors." *Id.*; see also *supra* text accompanying note 262.

art must be entirely separate from the donor's private residence, but may be located on the same overall property if the museum is situated in a remote area of the estate that affords an appropriate amount of privacy.³³⁶

Any new regulations should adopt a flexible approach to donor involvement: A reasonable amount of donor control should be permitted during the donor-founder's lifetime, and the donor's family members should be able to participate in the museum's governance.³³⁷ Donors should be allowed to oversee these charitable organizations, or take on a more curatorial role, so long as their involvement is in furtherance of the organization's tax-exempt purposes.³³⁸ The tax law should tolerate some entanglement with donor-founders and their family members—and, in some instances, insubstantial private benefits—to promote further investment in these jewel-box private museums. Billionaire collectors often have a remarkable eye for art, and have the means to buy some of the best works available in the contemporary market.³³⁹

2. Case Study: The Hill Art Foundation

To illustrate these points, consider the new museum development project by billionaire art collector J. Tomilson Hill, Vice Chairman of the Blackstone Group.³⁴⁰ Hill decided to open a private art museum that “will become one of the few private galleries in New York City largely made up of a personal collection.”³⁴¹ According to Hill, the museum will be primarily comprised of pieces from his \$800 million private collection, but may also borrow artworks from collections with which Hill has a relationship.³⁴² Despite Hill's relationship with some of the donors and institutions that he plans to partner with, the way the foundation is structured

³³⁶ See *infra* notes 397–98 and accompanying text.

³³⁷ See *infra* Part V.

³³⁸ See *infra* text accompanying notes 378–81; see also *supra* Section III.B.2 (discussing the Glenstone Foundation).

³³⁹ Cf. *infra* text accompanying notes 380–81.

³⁴⁰ Robin Pogrebin, *A Billionaire Is Opening a Private Art Museum in Manhattan*, N.Y. TIMES (July 28, 2016), <https://www.nytimes.com/2016/07/29/arts/design/a-billionaire-is-opening-a-private-art-museum-in-manhattan.html> [<https://perma.cc/SD9Z-C3A4>].

³⁴¹ *Id.*

³⁴² See *id.*

seems to weigh in favor of tax exemption by virtue of its tremendous public benefits. Though Hill acknowledged that the tax benefits were a motivation, he agreed with the IRS's concern about private benefits, stating that "he would never open a gallery near one of his residences, as the paper magnate Peter Brant has done"³⁴³ Hill does not plan to name the building after himself,³⁴⁴ a similar sentiment among other notable collectors.³⁴⁵ Naming a private museum after oneself may outwardly reflect the founder's own significance in creating the foundation, but it has little bearing on the actual level of donor control, or the effectiveness of the organization in accomplishing its charitable purposes.³⁴⁶ The foundation will make Hill's collection more accessible to the public—admission will be free for visitors, and the gallery space will be open on weekdays and Saturdays.³⁴⁷ In response to the growing number of public schools that have cut funding for arts programs, the museum will make art more accessible for children, and will provide educational arts programming for local New York City public school students.³⁴⁸ Hill plans to partner with other more established institutions in New York "like the Studio Museum in Harlem and the Metropolitan Museum of Art, where Mr. Hill serves on the board."³⁴⁹ Despite the financial incentives and donor involvement, the Hill Foundation highlights the need for private museums to maintain their tax-exempt status: These operating foundations "provide crucial educational services . . . [that] are instrumental to continuing" art education in communities for children and adults.³⁵⁰

³⁴³ *Id.*; see also *supra* text accompanying notes 208–11.

³⁴⁴ Pogrebin, *supra* note 340.

³⁴⁵ *Id.* Unlike other private collectors, Mitchell and Emily Rales, prominent art collectors and the founders of the Glenstone Foundation, intentionally chose not to name the museum after themselves. *Message from the Founders*, GLENSTONE, <http://www.glenstone.org/about> [<https://perma.cc/RW9Y-A3UY>].

³⁴⁶ Compare discussion *supra* Section III.B.2, and *infra* Section V.C (discussing the Glenstone Foundation), with discussion *supra* Section III.C, and *infra* Section V.B (discussing the Brant Foundation).

³⁴⁷ Pogrebin, *supra* note 340.

³⁴⁸ *Id.*

³⁴⁹ *Id.*

³⁵⁰ Crawford, *supra* note 45, at 37.

V. FACTORS TO ASSESS PRIVATE BENEFITS

“It was not just writing a check to support bricks and mortar or an exhibition, but a larger impact of what this could mean to the city and all future audiences.” – Jennifer Wells Green³⁵¹

The Senate Finance Committee Inquiry has drawn widespread attention to the art world, signifying the need to reassess how these private benefit restrictions apply to private tax-exempt art museums. The failure to clearly define what constitutes a substantial private benefit, or provide these institutions with clear guidelines, has allowed some wealthy individuals to take advantage of the Code without providing meaningful public benefits.³⁵² According to Sheldon Cohen, former Commissioner of the IRS, “when used as intended, the tax code’s breaks for art collectors balance private interests with the public good.”³⁵³ The incidental benefits analysis focuses on whether these benefits are *substantial enough* to jeopardize a private museum’s tax-exempt status.³⁵⁴ Private benefits should continue to be evaluated on a case-by-case basis, where certain factors weigh in favor of exemption more than others. When considering the totality of the circumstances, it is practically impossible to create a private museum without conferring some benefit on behalf of the donor-founder.³⁵⁵ These organizations should be judged by the amount of harm done to the institution, not just the public benefit, and should only be held liable or subject to penalties where there is evidence of significant abuse.³⁵⁶

The overall benefits that private museums provide are “a long-term public good” that far outweigh some of the private benefits discussed in Section III.D, such as donor control, or in some cases, limited access or hours of operation.³⁵⁷ Private benefits should only

³⁵¹ Perman, *supra* note 63.

³⁵² Rodgers, *supra* note 126.

³⁵³ See Kocieniewski, *supra* note 316.

³⁵⁴ See discussion *supra* Section III.C.

³⁵⁵ See Kocieniewski, *supra* note 316. Cohen said: “If an art collector makes significant contributions, and the public actually gets access to the works they are donating, then the major thing the collector gets is prestige and social status.” *Id.*

³⁵⁶ See generally Marsh, *supra* note 156, at 623–24.

³⁵⁷ Cohen, *Writing Off the Warhol Next Door*, *supra* note 3; see also *supra* Part III (applying the private benefit analysis).

be disqualifying in situations where the charitable deductions are not being used in furtherance of the organization's tax-exempt purposes.³⁵⁸ This Part illustrates various factors by which to assess the private benefit analysis—including the size and scale of museums, degree of closeness to the donor-founder, physical location, and amount of public access—and describes how these guidelines should apply to private operating foundations.

A. Consider the of Size and Scale of Museums When Examining Visitor Data

Congress should have a say in how tax dollars are spent, but to the extent possible, it should evaluate an organization's tax-exempt activities relative to the private benefit.³⁵⁹ Unlike traditional businesses, it is more difficult for museums to implement objective performance measures to determine whether an organization satisfies the public benefit requirement.³⁶⁰ Museums have cautioned against using statistical data as objective criteria when determining the effectiveness of private museums.³⁶¹ Instead, any evaluation of their programming should be on a subjective basis.³⁶² For example, when examining museum data, such as visit counts, these institutions should be compared to similarly situated institutions (i.e., museums similar in size, type, exhibition space, tourism, etc.).³⁶³ Visitor data is informative: A number of American museums are motivated to maximize their visit counts to generate income from sources such as admissions, "sales, exhibition entrance fees," and these numbers often justify the need for greater financial support.³⁶⁴

³⁵⁸ See Fricke, *supra* note 77, at 1166.

³⁵⁹ *Id.*

³⁶⁰ For one, a more objective approach may only assess more symptomatic effects, rather than the actual underlying phenomena, similar to the visitor count discussed in Section III.D.3. See SMITHSONIAN INST. OFFICE OF POLICY & ANALYSIS, *supra* note 9, at 8. Furthermore, statistical data fails to take into many external factors (i.e., the discussion of comparing similarly situated institutions). *Id.* Lastly, any assessment of visitor surveys will conflate a more complex relationship between the museumgoer and his environment in terms of satisfaction or visitor ratings. *Id.* at 15.

³⁶¹ *Id.* at 14–15.

³⁶² Compare discussion *supra* Section III.D.3., with discussion *infra* Section V.D.

³⁶³ See SMITHSONIAN INST. OFFICE OF POLICY & ANALYSIS, *supra* note 9, at 9.

³⁶⁴ *Id.* at 8.

In application, such considerations do not have the same effect on richer institutions, and are inherently flawed.³⁶⁵ Visitor data is not representative of the overall population—the captured demographics of museumgoers tend to be highly educated individuals, or the “educational elite.”³⁶⁶ Museums’ heavy reliance on donors (both financially and to gift artworks) has the effect of “alienat[ing] . . . the general public,” and visitors tend to be upper- and middle-class individuals.³⁶⁷ As a result, the general public views these institutions as inaccessible: “This ‘elite subordination of the museum’ simply affirms the class status of the rich and educated” and undermines the organization’s ability to provide meaningful public benefits.³⁶⁸ Museums often use the number of visits to indicate their public impact; however, the number of visitors is not necessarily equated with public impact.³⁶⁹ In some instances visitor data may be useful in making the determination, but should not be a determinative factor to merit the revocation of private museum’s tax-exempt status, except in egregious cases.³⁷⁰

³⁶⁵ *See id.* at 8–9.

³⁶⁶ *Id.* at 6–7.

³⁶⁷ Karayan, *supra* note 188, at 475.

³⁶⁸ *Id.* (quoting FIONA MCLEAN, *MARKETING THE MUSEUM* 75 (1997)).

³⁶⁹ “First, the number of visits is not the same as the number of people served.” SMITHSONIAN INST. OFFICE OF POLICY & ANALYSIS, *supra* note 9, at 8. The number of art museumgoers has likely increased—but perhaps not substantially—“over the last few decades probably because there are more museums,” and the numbers may include those individuals who revisit the same museums or other affiliated institutions. *Id.* Second, “the quality of programs (i.e., the satisfaction they provide users),” is distinguishable from “the draw of such programs.” *Id.* Third, “a shift in priority (and presumably resources) from collecting and research to exhibitions and community programs” may not have an immediate effect on the number of visits. *Id.* Successful outreach to new audiences may require those individuals to fundamentally change their impressions of museums. *Id.*

³⁷⁰ *See* Letter from Orrin G. Hatch to John Koskinen, *supra* note 12 (finding that, in one instance, a museum reported that as few as “456 people visited between October 2 and November 11, 2015,” whereas another museum averaged 35,000 visitors over a period of five years).

B. Donor Involvement—Though Unorthodox—Leads to Innovative Results and Should Be Permissible So Long as the Private Benefit Is Not Egregious

To limit donor involvement, it is imperative that private museums diversify their “funding sources.”³⁷¹ One approach to ensure that these private art museums act in the public interest, is to forbid donors and their family members from any involvement in the management of the foundation’s assets and governance.³⁷² Museum founders and their family members often serve on the board or in management positions in the foundation—an indicator for donor control and abuse.³⁷³ Donor-controlled private museums “will reflect the strengths and weaknesses of the founder”³⁷⁴ However, private museums rely heavily on individual gifts from wealthy donors, and may not be able to survive on other methods of financial support.³⁷⁵ Organizations primarily led by their founders pose a unique set of challenges, including: “feelings of ownership, board selection, inability or lack of expertise of direct management of the type of organization that they founded, feeling stifled from a staff standpoint, questions of motivation and collaboration from outsiders, and deep public association of the organization with the founder.”³⁷⁶ Critics of donor involvement argue that private museums will fare better with a more diverse management

³⁷¹ Jasmine Kusumowidagdo, *Adding Up the Arts: The Great Recession and the Public-Private Debate in the Funding of America’s Art and Art Museums* 32 (Apr. 22, 2016) (unpublished B.A. thesis, Scripps College) (on file with the Fordham Intellectual Property, Media & Entertainment Law Journal).

³⁷² Rodgers, *supra* note 126, at 63.

³⁷³ *Cf.* Plumstead Theatre Soc’y, Inc. v. Comm’r, 675 F.2d 244, 245 (9th Cir. 1982). Control by an individual who established the foundation is problematic where the founder actively participates in its management, or benefits from, or has a significant voice in how the organization is operated. *E.g., id.*; Plumstead Theatre Soc’y, Inc. v. Comm’r, 74 T.C. 1324, 1334 (1980), *aff’d*, 675 F.2d 244 (9th Cir. 1982).

³⁷⁴ Crawford, *supra* note 45, at 36. A museum is more likely to thrive when it is independently governed by “art expert[s] or a diverse group of knowledgeable individuals . . . better suited to operate a museum when compared to donors or their families.” Rodgers, *supra* note 126, at 63 (citation omitted).

³⁷⁵ See Kusumowidagdo, *supra* note 371, at 26, 32; see also *supra* Section IV.A.1 (providing a more robust discussion of the particular set of issues that donor control creates for private operating foundations).

³⁷⁶ Crawford, *supra* note 45, at 36.

structure.³⁷⁷ Any changes, if any, should avoid a blanket prohibition against any connection between the donor-founder and the organization's governance structure. Too stringent rules may discourage organizations where the donor-founder oversees the management of the museum, and in turn, has unfettered discretion over how the museum provides meaningful public benefits.

Critics of the private museum phenomenon argue that wealthy art collectors may not have a good eye for works, and in turn, are ill-equipped to take on curatorial or managerial roles, even in the case of their own museums.³⁷⁸ Conversely, in many instances involvement by donors and their family members is compatible with the organization's tax-exempt purpose. The donor-founder is more likely than not to be well-versed "in the area in which he or she collects."³⁷⁹ Private foundations are a reflection of the donor's acquisition strategy and curatorial insight—private contemporary art museums are able to take greater risks than more established museums.³⁸⁰ Due to the immense amount of wealth attributed to their billionaire donor-founders, these private museums are generally not subject to the same practical constraints as their public counterparts.³⁸¹

For example, the Brant Foundation is directed by the founder's daughter, and the founder, Peter Brant, tends to do a lot of the curating himself.³⁸² Similar to other wealthy art collectors, Brant is a tastemaker, known for his dedication to collecting contemporary art.³⁸³ Works in his collection include established artists like Andy Warhol, who he has collected since the 1960s, and contemporary artists, such as Jeff Koons (who he was an early collector of), Dan Colen, Julian Schnabel, and Cady Noland.³⁸⁴ In November 2013, Brant made a record-breaking sale of Jeff Koons' *Balloon Dog*

³⁷⁷ See Rodgers, *supra* note 126, at 63.

³⁷⁸ See Shnayerson, *supra* note 42.

³⁷⁹ Marsh, *supra* note 156, at 623.

³⁸⁰ PRIVATE COLLECTORS, AND THE PUBLIC BENEFIT, *supra* note 37.

³⁸¹ For discussion of donor aesthetic and financial discretion, see generally *supra* Sections III.A, III.B.1.

³⁸² See *About Us*, BRANT FOUND., <http://brantfoundation.org/about-us/> [<https://perma.cc/QH9Z-79XX>] (last visited Apr. 17, 2017); see also Goldstein, *supra* note 54.

³⁸³ See Goldstein, *supra* note 54.

³⁸⁴ *Id.*

(*Orange*) for \$58.4 million at Christie's auction house, "the highest price fetched by the work of a living artist at auction."³⁸⁵ Brant was motivated to sell this incredibly high-value work, in part, because he could contribute the proceeds from the sale to the Brant Foundation's endowment fund to help accomplish his long-term goals for the organization.³⁸⁶ The ability for donor-founders and their family members to be involved in their own operating foundations encourages greater participation by wealthy-individuals in the private museum sector, and may lead to unexpected results that have a tremendous impact on the cultural landscape.

Donor-founders have the ability to cultivate their creative vision to produce remarkable cultural relics. According to its mission statement, the Judd Foundation was founded to preserve the legacy of the widely-celebrated minimalist artist Donald Judd, and to show and preserve his artworks.³⁸⁷ Judd's two children—who serve as the President and Vice President of the Foundation's board—helped the organization recover from crippling debt and open new spaces across the country.³⁸⁸ The Judd Foundation campus in Marfa, Texas, is a minimalist art mecca that shows "museum-quality" artworks and design, and has helped to transform the previously desolate desert town into a thriving art destination.³⁸⁹ The Foundation is revered as a model success story of the influential role that private museums play within the art world.³⁹⁰

³⁸⁵ *Id.*

³⁸⁶ *Id.*

³⁸⁷ *About*, JUDD FOUND., <http://juddfoundation.org/foundation/about/> [<https://perma.cc/2VUE-QNXT>] (last visited Apr. 17, 2017).

³⁸⁸ *See generally* Zoë Lescaze, *Specific Objectives: The Complex Task of Preserving Donald Judd's Legacy*, ARTNEWS (Sept. 12, 2016, 9:15 AM), <http://www.artnews.com/2016/09/12/specific-objectives-the-complex-task-of-preserving-donald-judds-legacy/> [<https://perma.cc/RN9B-NL3A>]. Judd's children inherited millions of dollars in debt after the artist's premature death; however, the organization has recovered and is now in good financial standing. *Id.*; *see also* Alexandra Lange, *Donald Judd's House*, NEW YORKER (May 13, 2013), <http://www.newyorker.com/culture/culture-desk/donald-judds-house> [<https://perma.cc/YFC2-X85C>] (discussing the Judd Foundation's New York SoHo Loft space at 101 Spring Street, which recently underwent "a three-year, twenty-three-million-dollar restoration process" before opening its doors to the public, after the building was left in disrepair).

³⁸⁹ Lange, *supra* note 388; *see also* Lescaze, *supra* note 388.

³⁹⁰ *See generally* Lescaze, *supra* note 388.

Founder-led organizations also create more positive dynamics, such as greater innovation, long-term investment in the organization's growth and success, and dedication to the organization's overall charitable purpose.³⁹¹ Hence, not all involvement by founders or their family members is detrimental to a private museum's charitable purposes. The tax regime should provide private operating foundations with enough leeway to cultivate their own unique collecting strategies and institutional goals, to ensure that these "jewel-box" museums continue to thrive and make significant contributions within the nonprofit art museum sector.

C. Though the Proximity to the Founder's Private Residence Is an Indicator of Abuse, Private Museums Play a Significant Role in Improving Local Economic and Cultural Development

The IRS advises donors to never display the collection in their residences.³⁹² The IRS has revoked tax exemption in cases where a taxpayer places artworks on his or her estate, and determined that, under section 4941 of the Code, the use of a private foundation's income or assets by a disqualified person constitutes a substantial private benefit.³⁹³ In Revenue Ruling 74-600, the IRS investigated the founder of a private foundation for displaying paintings owned by the organization in his home, which were returned to him after being exhibited in a number of museums.³⁹⁴ There is likely to be a substantial private benefit when a donor displays artwork within his or her home, considering that this practice is outside the scope of standard museum operations.³⁹⁵ As the Committee pointed out, it

³⁹¹ See Perman, *supra* note 63. See generally discussion *supra* Section IV.B.

³⁹² See Rev. Rul. 74-600, 1974-2 C.B. 385; see also LERNER & BRESLER, *supra* note 20, at 1300.

³⁹³ See *supra* notes 246-47 and accompanying text. The IRS took notice of "the limited use by others," and the fact that there were no signs to advise the public that they were welcome to tour the property. I.R.S. Priv. Ltr. Rul. 88-24-001 (Nov. 5, 1987). While some of the sculptures were viewable from the road, and "in theory available to the general public, it [was] primarily only those who [were] affiliated with the art museums and schools who receive full advantage of their availability." *Id.*

³⁹⁴ Rev. Rul. 74-600, 1974-2 C.B. 385. Even though 2,000 individuals visited the founder's private collection each year, including special tour groups, the IRS ruled that the founder was "in direct use of the foundation's assets." *Id.* The IRS determined that the placement of the painting in the founder's residence constituted a private benefit, and thus, disqualified the foundation's status as a tax-exempt organization. *Id.*

³⁹⁵ See *id.*; see also Kleinman & Spell, *supra* note 240.

is more ambiguous when a private museum displays its collection near or on the founder's property.³⁹⁶ In some instances, a donor should be allowed to build a tax-exempt museum near or on her property, so long as the building is clearly marked with signage, publicly accessible, and does not possess any qualities of artifice (i.e., constructed with the intent to manipulate the Code).³⁹⁷ However, this option is likely limited to a particular subset of "donors with estates that are large enough to" build a structure on an entirely separate portion of their property with a suitable amount of privacy.³⁹⁸ Certain practical considerations may also deter private collectors from exhibiting their artworks within their homes.³⁹⁹ Many donors are opening unique exhibition spaces such as warehouses, or newly designed private art museums and exhibition spaces, to accommodate modern artworks, which are often large-scale installations or works that require special attention such as video art.⁴⁰⁰

Consider Glenstone, which is located in an "improbable place[] . . . separated from the Rales' home by a large duck pond," and has attendance records of roughly 10,000 visitors from 2006 to 2013.⁴⁰¹ Though this arrangement may appear suspect, the museum provides greater public benefits that warrant tax exemption. Glenstone houses a remarkable collection of post-war and contemporary art, and has lent more than 400 artworks to other arts institutions, both domestically and internationally.⁴⁰² Images of the museum's permanent collection, exhibitions, and artworks on loan are

³⁹⁶ For discussion of Senator Hatch's findings, see generally *supra* Section III.D.

³⁹⁷ See, e.g., Kleinman & Spell, *supra* note 240 (discussing Rev. Rul. 74-600, 1974-2 C.B. 385). A museum should be "well publicized, [and] physically separated from the donor's personal living spaces." *Id.*; see also Cohen, *Writing Off the Warhol Next Door*, *supra* note 3.

³⁹⁸ Kleinman & Spell, *supra* note 240. To avoid an adverse ruling, it is preferable that the structure not be attached to the donor's residence. See *id.* The location should be permissible so long as the donor did not utilize the collection for personal use, and opens the private exhibition space to the public. See LERNER & BRESLER, *supra* note 20, at 1300.

³⁹⁹ Kino, *supra* note 48.

⁴⁰⁰ *Id.*

⁴⁰¹ Cohen, *Writing Off the Warhol Next Door*, *supra* note 3.

⁴⁰² See *id.*; see also Form 990, *supra* note 192, at pt. IX, Attachment 15.

available online.⁴⁰³ Furthermore, Glenstone aims to increase its numbers to 25,000 annually, and is also undergoing a new expansion project that is expected to increase its visitors four or five-fold.⁴⁰⁴ Allowing taxpayers to found a museum on their property incentivizes participation, and is likely more cost-effective for donors.⁴⁰⁵ Nearly sixty percent of private museums are located near their founder's residences.⁴⁰⁶ To rule against the ability to build tax-exempt exhibition spaces near their homes would likely create detrimental effects on the private museum sector.

Critics may also object to the placement of museums in rural areas, particularly when placed near the founder's personal residence.⁴⁰⁷ For example, *In re Barnes Foundation*, the Barnes Foundation was ordered to move from its original rural location to Philadelphia.⁴⁰⁸ While its new home provides greater visibility, and has elevated the museum to an internationally renowned institution, there is still merit in placing museums in less densely populated rural communities.⁴⁰⁹ Nearly twenty-six percent of museums, private and public, are located in rural areas.⁴¹⁰ Museums can have tremendous economic effects, and help to develop both rural and urban communities: Museums help generate tourism, create jobs, encourage community engagement, and provide enriching cultural experiences for visitors.⁴¹¹ The majority of museums' mission statements reflect a "community-focused spirit."⁴¹²

⁴⁰³ See *Art*, GLENSTONE, <http://www.glenstone.org/art> [<https://perma.cc/PA5R-5VKR>] (last visited Apr. 13, 2017).

⁴⁰⁴ Cohen, *Tax Status of Museums Questioned by Senators*, *supra* note 15.

⁴⁰⁵ See, e.g., *supra* notes 128–30, 277 and accompanying text. *But cf. infra* notes 427–31 and accompanying text.

⁴⁰⁶ Crawford, *supra* note 45, at 40.

⁴⁰⁷ For historical background on the Barnes Foundation, see *supra* Section III.B.1.

⁴⁰⁸ See *In re Barnes Found.*, No. 58,788, 2004 WL 2903655, at *1, *19 (Pa. Ct. Com. Pl. Dec. 13, 2004).

⁴⁰⁹ "The arts help to address some of the unique challenges faced by rural communities, including geographic isolation, infrastructure limitations and population flight." NAT'L ASSEMBLY OF STATE ARTS AGENCIES, *supra* note 125, at 10. Private art museums "can help to diversify rural economies by creating sustainable small businesses, improving quality of life for residents, and attracting visitors and investment." *Id.*

⁴¹⁰ *Museum Facts*, *supra* note 51.

⁴¹¹ Crawford, *supra* note 45, at 37.

⁴¹² *Id.* at 40.

In the context of urban development, “the focus is simply on the presence of the museum in the community, rather than the specific offerings found within the museum”⁴¹³ For example, the Rubell Family Collection helped transform the Miami arts district after opening in a former Drug Enforcement Administration warehouse in 1993, and now draws tens of thousands of visitors each year.⁴¹⁴ Founded by Mera and Donald Rubell, the Rubell Family Collection is one of the most notable modern art collections in the United States, and has expanded to rival prominent arts institutions such as the Whitney Museum of American Art in New York.⁴¹⁵ The Rubell Family Collection created ripple effects across the country—more prominent art collectors began to take notice of the private art foundation phenomenon, and modeled their own private foundations on this “Miami [Organizational] Model.”⁴¹⁶ More private foundations followed suit and situated themselves in this once blighted neighborhood, which has developed into Miami’s now thriving arts district.⁴¹⁷ Iconic art museums can substantially impact economic regeneration in their communities.⁴¹⁸ These institutions serve as “cultural attractions” that help “stimulate business development and allow communities to profit from the growing market of cultural tourism.”⁴¹⁹

D. Public Benefit Calls for Greater Public Access

To satisfy the provisions of section 501(c)(3), private museums must provide tangible public benefits, which implies that there should be some degree of access by the general public.⁴²⁰ While the exact meaning of public benefit is unclear in the context of private operating foundations, the general consensus is to consider the effects that a museum has on its visitors as a central tenet of museum policy.⁴²¹ The act of accessioning an artwork confers on the mu-

⁴¹³ Karayan, *supra* note 188, at 477.

⁴¹⁴ Cohen, *Tax Status of Museums Questioned by Senators*, *supra* note 15.

⁴¹⁵ Kino, *supra* note 48.

⁴¹⁶ Crawford, *supra* note 45, at 3.

⁴¹⁷ *See id.*

⁴¹⁸ Plaza et al., *supra* note 252, at 180–82.

⁴¹⁹ Karayan, *supra* note 188, at 477.

⁴²⁰ *See* Cohen, *Writing Off the Warhol Next Door*, *supra* note 3.

⁴²¹ SMITHSONIAN INST. OFFICE OF POLICY & ANALYSIS, *supra* note 9, at 6.

seum an inherent obligation to serve in the public interest with respect to the donated artwork.⁴²² In the art world, the donation of an artwork to a museum is in itself “considered the ultimate boon to the public good,” whereas Congress is suspicious of “any charitable deduction that is not backed by a concrete act of giving . . . , even if the end result benefits ‘[a]rt.’”⁴²³ To best serve its overall charitable purposes, a private museum’s hours of operation should be reasonable in proportion to the foundation’s resources, and should not be so unfriendly to deter visits from potential museumgoers.⁴²⁴ It is fairly common for museums to operate only a few days a week, thus smaller private museums should not be expected to be open more than three or four days a week.⁴²⁵

The same logic should be applied to museum admission fees and reservation systems.⁴²⁶ For 2014 and 2015, museumgoers “spent an average of eight dollars per visit,” and only one-third offered free admission.⁴²⁷ Though the cost for a museum visit seems relatively low, the median investment for each individual visitor is about fifty-five dollars,⁴²⁸ and this high cost requires museums to earmark a portion of their operating budgets to subsidize the cost of admission.⁴²⁹ Any public benefit assessment must con-

⁴²² See *Code of Ethics for Museums*, *supra* note 9.

⁴²³ Strom, *supra* note 286.

⁴²⁴ For discussion of the Hall Foundation’s admissions policies, see *supra* note 263. The Hall Foundation had about 1,500 visitors from 2013 to 2014, and operates three days a week for a period lasting only six months per year. Cohen, *Writing Off the Warhol Next Door*, *supra* note 3.

⁴²⁵ Cf. *Location, Hours, and Admission*, MUSEUM MOD. ART, <https://www.moma.org/visit/index> [<https://perma.cc/2RCF-G3LZ>] (last visited Apr. 13, 2017). MoMA PS1, an affiliate of the Museum of Modern Art in Manhattan, is closed on Tuesdays and Wednesdays. *Id.*

⁴²⁶ For a discussion of various museum’s admission policies, see *supra* Section III.D.3.

⁴²⁷ ASS’N OF ART MUSEUM DIRS., ART MUSEUMS BY THE NUMBERS 2015 1, 6 (2016), <https://aamd.org/sites/default/files/document/Art%20Museums%20By%20The%20Numbers%202015.pdf> [<https://perma.cc/HX75-MEPU>] (noting that “the average amount visitors spent per museum visit . . . include[s] the cost of admission and any ancillary purchases (internal punctuation omitted)); cf. John, *supra* note 22. The average cost of admission has steadily increased since 2012, when “[t]he average price for admission [was] about seven dollars, and . . . [t]he median cost to museums per visitor [was] about \$31.40.” John, *supra* note 22.

⁴²⁸ ASS’N OF ART MUSEUM DIRS., *supra* note 427.

⁴²⁹ John, *supra* note 22. Slightly more than one-third of museums offer free admission, or suggested admission fees. *Id.*; cf. *Museum Facts*, *supra* note 51.

sider the costs of running a private operating foundation, and the financial ramifications of any new policy changes for the private museum sector. Increases in the number of visitors and hours of operation affect “security, insurance, and museum staffing costs[,] . . . [which] are not usually covered by increased attendance and admission charges.”⁴³⁰ Smaller organizations with less funding may not be able to survive if free admission was mandatory for private museums. This evinces the need for continued tax subsidies to help arts institutions better sustain themselves, especially when private museums help to alleviate government spending within the arts sector.⁴³¹

Despite Senator Hatch’s misgivings about appointment-only and advanced reservation systems, this is standard practice for museums.⁴³² Reservations are common among more established public museums.⁴³³ The National Museum of African-American History and Culture (“NMAAHC”) in Washington, D.C., has quickly ascended in the ranks to become one of the most popular “superstar museums” in the country.⁴³⁴ The NMAAHC has welcomed over 750,000 visitors since opening in September 2016—far more than originally anticipated.⁴³⁵ The NMAAHC offers free admission, but requires visitors to reserve timed entry passes.⁴³⁶ Passes are fully booked several months in advance, though the museum allows a limited number of same-day visits.⁴³⁷ Private museums should also

⁴³⁰ THOMPSON, *supra* note 61, at 224.

⁴³¹ For discussion on the economic decline in government spending in the nonprofit museum sector, see *supra* Section I.B.

⁴³² See Letter from Orrin G. Hatch to John Koskinen, *supra* note 12.

⁴³³ *Id.*; see also *supra* notes 264–67 and accompanying text.

⁴³⁴ See Heather Long, *New African-American Museum ‘Sold Out’ Through March 2017*, CNN (Oct. 24, 2016, 9:52 AM), <http://money.cnn.com/2016/10/21/news/economy/museum-of-african-america-history-and-culture-passes> [<https://perma.cc/YGM7-7Z64>].

⁴³⁵ *More Options for Visiting the National Museum of African American History and Culture Starting Jan. 4*, SMITHSONIAN: NEWSDESK (Jan. 4, 2017), <http://newsdesk.si.edu/releases/more-options-visiting-national-museum-african-american-history-and-culture-starting-jan-4> [<https://perma.cc/LBS3-PMN7>] [hereinafter *More Options for Visiting*]. “The museum did conduct a study prior to the opening, and accordingly expected 7,500 visitors daily. Instead, 30,000 people have tried to get in some days. (The museum can admit about 8,000).” Long, *supra* note 434.

⁴³⁶ *More Options for Visiting*, *supra* note 435.

⁴³⁷ Long, *supra* note 434. As of October 2016, passes were sold out through March 2017. *Id.*

accommodate same-day appointments to allow for more spontaneous visits, but should not be required to provide all same-day visitors admission when they are in high demand.⁴³⁸ Similar to the NMAAHC, the Broad Museum in Los Angeles, California, has been so popular since opening its doors in September 2015 that wait times for same-day admission range from ten to forty-five minutes on weekdays, and from sixty to ninety minutes on weekends.⁴³⁹ The museum recently changed its reservation system to make it easier for visitors to book free tickets online.⁴⁴⁰ Glenstone requires scheduled visits, but unlike other institutions, appointments may be scheduled on the same day and are free.⁴⁴¹ Once Glenstone completes its expansion project in 2018, it will continue the reservation system “on its website to make sure that everyone enjoys an unhurried and less crowded experience.”⁴⁴² While these in-demand museums may serve as a model, private museums should aim to create admission policies that cater best to their financial and institutional needs.

Last, the availability of online catalogues of a private museum’s art collection is a positive factor that weighs in favor of exemption, but should only be examined in light of the museum’s available resources. An increasing number of museums are digitizing their holdings, but this is a lofty and expensive undertaking to implement. A museum’s website is a good measure of online activity (not the outcome), provides beneficial resources, and can maximize public engagement.⁴⁴³

⁴³⁸ See generally Jessica Gelt, *Adapting to Demand, Broad Museum Changes Its Ticket Reservation System*, L.A. TIMES (Apr. 16, 2016, 3:40 PM), <http://www.latimes.com/entertainment/arts/culture/la-et-cm-broad-museum-ticket-reservations-20160426-story.html> [<https://perma.cc/DPE7-NZ87>]. After appointments started filling up three to four months in advance, the Broad limited visitors’ ability to book reservations up to one month in advance. *Id.*; see also note 61 and accompanying text.

⁴³⁹ Gelt, *supra* note 438.

⁴⁴⁰ *Id.*

⁴⁴¹ *Admission to Glenstone Is Always Free*, GLENSTONE, <http://www.glenstone.org/admission-glenstone-always-free> [<https://perma.cc/86DL-FW3P>] (last visited Apr. 13, 2017).

⁴⁴² Halperin, *supra* note 44.

⁴⁴³ SMITHSONIAN INST. OFFICE OF POLICY & ANALYSIS, *supra* note 9, at 13.

CONCLUSION

More wealthy art collectors are founding private museums than ever before. Although tax breaks for high-income individuals have recently come under fire due to concern over private benefits, this does not justify doing away with charitable deductions for private art museums altogether. By nature, tax incentives confer some sort of benefit on the founder, and should not disqualify an organization unless the private interests at stake significantly outweigh the public benefit. However, a museum's policies and programmatic efforts should ensure that the organization safeguards the public interest, and provides a beneficial service to society. The Code should preserve these institutions' tax-exempt status where appropriate, and should not enact overly prescriptive regulations that would hinder the private museum sector's ability to grow. Whether these private operating foundations satisfy the public benefit requirement under section 501(c)(3) should continue to be evaluated on a case-by-case basis. This analysis considers whether the museum's activities fulfill its tax-exempt charitable purpose, in light of the organization's available resources and funding. In all, it is better to tolerate some private benefit during the donor-founder's lifetime, so long as it is not egregious. The Code should continue to encourage wealthy donors to create their own private operating foundations: These private art institutions provide invaluable public benefits, promote growth in the nonprofit museum sector, and safeguard priceless artworks for the benefit of future generations. By allowing donor-founders to carry out their unique vision, private museums provide greater autonomy for these institutions to cultivate more avant-gardes collections, and can lead to innovative and unexpected results.