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Thomas Kelley

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## Rediscovering Vulgar Charity: A Historical Analysis of America's Tangled Nonprofit Law

### Cover Page Footnote

Clinical Professor of Law and supervisor of the Community Development Law Clinic, University of North Carolina at Chapel Hill School of Law. A.B., Harvard 1984, J.D., Northeastern 1991. Thanks to my colleagues Gail Agrawal, Melissa Jacoby, Gene Nichol, and Deborah Weissman for guidance and encouragement; to my research assistants Jeffery Berger, and Debra Eidson, for chasing down, among other things, obscure historical works; to Bill McCarthy, for providing me a comfortable space in which to think; and to the Council for Interational Exchange of Scholars, on whose time I wrote the final sections of this Article.

## ARTICLES

# REDISCOVERING VULGAR CHARITY: A HISTORICAL ANALYSIS OF AMERICA'S TANGLED NONPROFIT LAW

*Thomas Kelley\**

It is as if I were sitting on the neck of a man, and, having quite crushed him down, I compel him to carry me, and will not alight from off his shoulders, while I assure myself and others that I am very sorry for him, and wish to ease his condition by every means in my power except by getting off his back.<sup>1</sup>

## INTRODUCTION

Charitable<sup>2</sup> organizations in the United States find themselves in a

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\* Clinical Professor of Law and supervisor of the Community Development Law Clinic, University of North Carolina at Chapel Hill School of Law. A.B., Harvard 1984, J.D., Northeastern 1991. Thanks to my colleagues Gail Agrawal, Melissa Jacoby, Gene Nichol, and Deborah Weissman for guidance and encouragement; to my research assistants Jeffery Berger, and Debra Eidson, for chasing down, among other things, obscure historical works; to Bill McCarthy, for providing me a comfortable space in which to think; and to the Council for International Exchange of Scholars, on whose time I wrote the final sections of this Article.

1. Leo Tolstoy, *What Is to be Done?*, in *The Complete Works of Lyof N. Tolstoy* 81 (New York, Thomas Y. Crowell & Co. 1984).

2. The nomenclature of charity is variable and confusing. In its broadest sense, charity can be taken to mean giving help to those in need. See William Diaz, *For Whom and For What? The Contributions of the Nonprofit Sector, in The State of Nonprofit America* 517 (Lester M. Salamon ed., 2002). A standard dictionary definition provides that charity is:

1. the love of God for man or of man for his fellow men
2. an act of good will or affection
3. the feeling of good will; benevolence . . .
5. a) voluntary giving of money or other help to those in need b) money or help so given c) an institution or other recipient of such help . . .

Webster's New World Dictionary (Second College ed. 1972). Used in this sense, charity is a general term that encompasses everything from an individual giving a quarter to a homeless person on the street to private foundations that fund complex social purpose enterprises. Some commentators distinguish charity from philanthropy, defining the former as person-to-person attempts to alleviate suffering and the latter as more ambitious efforts that devote private resources to systematic social problems, not necessarily those that affect only the poor. See, e.g., Maurice G. Gurin & Jon Van Til, *Philanthropy in Its Historical Context, in Critical Issues in American Philanthropy: Strengthening Theory and Practice* 3 (Jon Van Til et al. eds., 1990) (calling philanthropy the "prudent sister" of charity" (internal quotation marks

double bind these days. On one hand, our free-market American culture expects them to be entrepreneurial and bottom line-oriented. Our government and the donor community tell them they must be lean and efficient, establish metrics to measure and ensure organizational outcomes, develop synergistic partnerships with for-profit organizations, identify and exploit their comparative advantages, recruit leadership with vision and entrepreneurial zeal, market themselves effectively, articulate their “deliverables,” and, often times, find ways to charge fees or otherwise generate earned income so that they can pay their own way.<sup>3</sup> In short, they must retool to become more like successful commercial enterprises. On the other hand, courts and governmental agencies, the Internal Revenue Service (“IRS”) in particular,<sup>4</sup> tell charitable organizations that if they

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omitted)); *see also* Bruce R. Hopkins, *The Law of Tax-Exempt Organizations* 87 (7th ed. 1998). The Filer Commission of the 1970s, which was charged with studying philanthropy and charity in the United States, avoided using those terms because it feared they smacked of *noblesse oblige*. It preferred the term “private giving for public purposes.” Comm’n on Private Philanthropy & Pub. Needs, *Giving in America: Toward a Stronger Voluntary Sector* 53 (1975) (internal quotation marks omitted). In the realm of American law, the term “charity” is exasperatingly variable and confusing. In cases and statutes charity is sometimes used in the general dictionary sense, described above. *See, e.g.*, *Ould v. Wash. Hosp. for Foundlings*, 95 U.S. 303, 311 (1877); *Bok v. McCaughn*, 42 F.2d 616, 619 (3d Cir. 1930). It also is used to refer to the general category of nonprofit organizations that qualify for tax exemption under section 501(c)(3) of the Internal Revenue Code. This broad category includes organizations that “test for public safety” and “foster national or international amateur sports competition[s].” I.R.C. § 501(c)(3) (2000); *see Hopkins, supra*, at 85. Next, the word charity denotes a still-broad subcategory within section 501(c)(3) comprised of those organizations and activities that engage in

Relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency.

Treas. Reg. § 1.501(c)(3)-1(d)(2) (as amended in 1990). In spite of these broad uses of the term charity, it sometimes is used more narrowly in the law to mean “assistance to the poor, the indigent, the destitute.” Hopkins, *supra*, at 86. This latter use sometimes is referred to as the “vulgar” meaning of charity. *Id.* Internal Revenue Service (“IRS”) regulations do little to clarify the legal meaning of charity. Regulations accompanying section 501(c)(3) tell us only that the word “charity” is used by the IRS in its “generally accepted legal sense.” Treas. Reg. § 1.501(c)(3)-1(d)(2). A good deal of this Article will be devoted to peeling back the layers of confusion over what we as a society and as a legal system mean by charity. For the sake of clarity, however, we shall begin with the assumption that the word “charity,” when it appears in this Article, is used in its broadest sense—the first definition discussed in this now over-long footnote—unless otherwise indicated.

3. *See infra* Parts II.D.1-2; *see also* Dennis R. Young & Lester M. Salamon, *Commercialization, Social Ventures, and For-Profit Competition, in The State of Nonprofit America, supra* note 2, at 423.

4. In theory, states’ attorneys general or other specified state authorities are charged with regulating charitable organizations. In fact, few states devote significant

follow the path to the marketplace, they may pay the ultimate price: loss of federal tax exemption. Charities live in fear of being ensnared by confusing and contradictory legal doctrines such as the operational test, the commerciality doctrine, the unrelated business income tax (“UBIT”), and the commensurate-in-scope doctrine, all designed, at least in part, to prevent them from looking and acting too commercial.<sup>5</sup>

Contemporary American charities might find some comfort in the knowledge that the problem is not of their making. The present fix they find themselves in has deep historical roots in the Anglo-American legal tradition. For several hundred years, our culture has developed a vibrant charitable tradition without ever agreeing as a matter of culture or law on what “charity” means.<sup>6</sup> In our tradition, and in our contemporary culture, charity is a compassionate act of aiding the poor, of distributing alms to the needy, and spooning soup to the hungry. At the same time, it is a tool for social engineering, for efficiently producing socially beneficial results that will lighten the burdens on our government. These are two very different conceptions of charity, but the legal doctrines that govern charity in the United States do not clearly distinguish between them.

This Article will argue that the increasing confusion in the contemporary American law of charity stems from the fact that our society has moved and is continuing to move toward a results-oriented, quasi-commercial, social engineer’s conception of charity, while our law has continued to encourage, and often insist upon, a compassionate brand of “vulgar” charity. Part I of this Article will take us back to the origins of Anglo-American charity so that we can understand where the definitional split began and how Anglo-American charity evolved to the point that vexes us today.<sup>7</sup> It will then discuss how those early conceptions of charity were transplanted

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resources to monitoring the charitable nonprofit sector, and the IRS, working through the tax code, has become the de facto watchdog. See James J. Fishman, *The Development of Nonprofit Corporation Law and an Agenda for Reform*, 34 Emory L.J. 617, 639 (1985).

5. See *infra* Part II.C.

6. See *supra* note 2 and accompanying text. Our confusion about the practical and legal definition of charity is remarkable when one considers that we in the United States like to view ourselves as a people committed to charity, philanthropy, and voluntary associations. See David Wagner, *What’s Love Got To Do With It? A Critical Look at American Charity*, ix-x, 1-2 (2000).

7. A wealth of scholarly material traces the roots of American charity and philanthropy back to the ancient Greeks and beyond. Many of these historical narratives pause for a significant examination of the Poor Laws of Elizabethan England, which most view as seminal to America’s law of charity. See, e.g., Walter I. Trattner, *From Poor Law to Welfare State: A History Of Social Welfare in America* (6th ed. 1999). For a British perspective, see Francis Gladstone, *Charity, Law and Social Justice* (1982). Though we will try not to belabor this oft-told history, we will review it thoroughly enough to understand the divergent trends that have led to the schizophrenic nature of American charity law.

to the United States, giving rise to our current legal confusion. Part II will focus on the law of charity in the United States, paying particular attention to four doctrines that are causing confusion and consternation for today's entrepreneurial charities because they are premised upon an unsettled cultural and legal definition of charity. This Article will not attempt to resolve the question of whether contemporary America's embrace of market-oriented, entrepreneurial charity is a positive or negative phenomenon. Nor will it provide a detailed policy prescription for getting us out of the mess we find ourselves in. However, Part III will offer a broad suggestion for adapting our laws to better fit our society's evolving conception of charity, and will put forward the simple conclusion that we as a society should not continue to do what we are doing. We should not force charities to embrace the marketplace and pay their own way, and at the same time leave in place legal doctrines that punish them for doing so. If we as a society are going to force charities and the people they serve to fend for themselves, then we have a moral, if not legal, obligation to get our legal system off their backs.

## I. ORIGINS AND DEVELOPMENT OF THE ANGLO-AMERICAN CONCEPTION OF CHARITY

### A. *Charity from Ancient Egypt to Elizabeth I*

#### 1. Charity As Love

According to the sociobiologist E.O. Wilson, “[g]enerosity without hope of reciprocation is the rarest and most cherished of human behaviors, subtle and difficult to define, . . . surrounded by ritual and circumstance, and honored by medallions and emotional orations.”<sup>8</sup> Because such altruistic behavior confers certain evolutionary advantages, it has become a selected and enduring trait in human beings.<sup>9</sup> Recently published research on the human brain seems to confirm that humans are wired to cooperate.<sup>10</sup>

Historians trace the concept of charity to civilizations that existed long before the birth of Christ. As early as 1300 B.C., ancient Egyptian civilization included the concept of “Maat,” which implied social justice and righteous dealings with one's fellow man.<sup>11</sup> Egyptians were buried with records of the “blessed giving[s]” they had

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8. Edward O. Wilson, *On Human Nature* 155 (1978).

9. *See id.* at 159.

10. *See* Natalie Angier, *Why We're So Nice: We're Wired to Cooperate*, N.Y. Times, July 23, 2002, at F1 (describing research in which MRI technology shows that selfless acts of cooperation stimulate important pleasure centers in the brain).

11. Gladstone, *supra* note 7, at 10.

shared with the poor during their lifetimes.<sup>12</sup> “In Early Mesopotamia, the Code of Hammurabi instructed Babylonians to protect the less fortunate and to care for the poor, widowed and orphaned.”<sup>13</sup> Buddhism, founded in 400 B.C., taught that love and charity were paramount virtues.<sup>14</sup> In Hindu scriptures, giving to the needy—particularly holy men dependent on alms—was a duty and could reward the donor in a future existence.<sup>15</sup>

The Anglo-American tradition of charity has Ancient Hebrew roots. Hebrew doctrine taught that providing for the needy was an essential part of a just society, and that not only did humans have a moral obligation to aid those in need, but those in need had a moral obligation to accept assistance.<sup>16</sup> Judaism made tithing compulsory, along with giving bread to the hungry, taking outcasts into the home, and clothing the naked.<sup>17</sup> Early Judaism stressed that a principal function of the synagogue was to organize charitable giving.<sup>18</sup> The Jewish notion of charity was bound up closely with the idea of love,<sup>19</sup> and a fundamental principal of the Torah is the command to love thy neighbor as thyself.<sup>20</sup>

Judaism was seminal to the early Christian concept of charity,<sup>21</sup> and it was through Christianity that the concept of charity became cemented in Anglo-American culture and law.<sup>22</sup> As Christianity

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12. Penina Kessler Lieber, *1601-2001: An Anniversary of Note*, 62 U. Pitt. L. Rev. 731, 732 (2001) (internal quotation marks omitted).

13. *Id.*; see Trattner, *supra* note 7, at 1; Stephen R. Block, *A History of the Discipline*, in *The Nonprofit Organization: Essential Readings* 46 (David L. Gies et al. eds., 1990).

14. Trattner, *supra* note 7, at 1.

15. Merle Curti, *Philanthropy*, in *The Nonprofit Organization: Essential Readings*, *supra* note 13, at 339.

16. Trattner, *supra* note 7, at 2; Curti, *supra* note 15, at 340; see Robert L. Payton, *A Tradition in Jeopardy*, in *Philanthropy and the Nonprofit Sector in a Changing America* 482 (Charles T. Clotfelter & Thomas Ehrlich eds., 1999) (indicating that the oldest books of the Old Testament include mandates to aid widows, orphans, strangers, and the poor).

17. Curti, *supra* note 15, at 340 (citing *Isiah* 58:7).

18. *Id.* at 340-41.

19. Gladstone, *supra* note 7, at 9, 15. The word charity derives from the Latin *caritas*, itself a translation of the Greek *agape*. *Agape* was the word chosen around 200 B.C. by the first translators of the Old Testament to represent the Hebrew *hab*, or love. Many stories of the Old Testament illustrate the importance of love and mercy.

20. *Id.* at 18 (noting that the Jewish conception of charity is bound up with the notion of combating injustice).

21. Curti, *supra* note 15, at 341.

22. See Gladstone, *supra* note 7, at 20. I do not mean to argue that Anglo-American charity is an exclusively Christian phenomenon. In his important work on American philanthropy, Robert Bremner offers the droll observation that the first philanthropists in the New World were the Native Americans who aided the struggling Pilgrims. Robert H. Bremner, *American Philanthropy* 5 (1960). Islam has also influenced this country's culture since before its founding, not least through the spiritual convictions of the Muslim men and women from Africa who were taken to this continent against their will. Anyone interested in the future of charity in this

spread rapidly across the Roman Empire in its waning days, the “practical application of charity was probably the most potent single cause of Christian success.”<sup>23</sup> The Roman Emperor Constantine converted to Christianity around 311 A.D. and he supported the church’s practical charitable work by assigning a fixed and generous proportion of provincial revenues to church charity.<sup>24</sup>

Early Christianity had a very particular view of its meaning. Jesus taught that love, mercy, and justice should be written on people’s hearts, even if not necessarily in their laws.<sup>25</sup> His followers were obliged to love their enemies, practice good deeds, offer alms generously, and thereby gain entrance into heaven.<sup>26</sup> In the early Christian view, the giving of alms was a spiritual rather than a social act, one that could bring the donor closer to a union with God.<sup>27</sup> The effect of charitable acts on the giver’s soul was doctrinally more significant than the effects on the body of the recipient.<sup>28</sup> If Christians in those days had any thoughts about eliminating the underlying causes of poverty, they probably would have opposed the notion, for if there were no poor, there would be no means by which the fortunate could buy divine grace.<sup>29</sup> By the fourth century, the concept of charity was well established in Christendom, but it had little to do with preventing poverty; it was about almsgiving in the face of perpetual and unavoidable need.<sup>30</sup>

It is significant for our purposes that the early Christian tradition assumed that poverty and need arose as part of God’s plan for mortals, and that it was just and proper for individuals within society to assume responsibility for the attendant suffering.<sup>31</sup> Individuals were afflicted by poverty as a result of God’s plan, not because they necessarily deserved to suffer. It followed that poverty and begging of alms could not be moral failings, and by no means could they be considered crimes.<sup>32</sup> Followers were obliged to identify and address

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country should take into account Islam’s growing influence within our borders. Like Judaism and Christianity, Islam places strong emphasis on giving to the poor and powerless, and almsgiving is one of its five pillars. See *Approaching the Qur’an: The Early Revelations* 38 (Michael Sells trans., 1999).

23. Gladstone, *supra* note 7, at 27 (quoting H. Chadwick, *The Early Church* 56 (1967)).

24. *See id.*

25. *Id.* at 22.

26. Comm’n on Private Philanthropy & Pub. Needs, *supra* note 2, at 62 (referring to this doctrine as “salvation at a price”); Wagner, *supra* note 6, at 82 (stating that in early Christian doctrine, an “alms giver could become ‘God’s creditor’”).

27. Curti, *supra* note 15, at 341.

28. B. Kirkman Gray, *A History of English Philanthropy*, vii (1905).

29. Wagner, *supra* note 6, at 82.

30. *Id.* *See generally* Curti, *supra* note 15.

31. *See* Trattner, *supra* note 7, at 4.

32. *Id.*



the needs of the poor without regard to their attractiveness or deservedness.<sup>33</sup>

After the fall of the Roman Empire, England and parts of Europe experienced a long period in which no state and no secular institution was equipped to provide relief for the poor and distressed. The Church of Rome became the primary front of charitable work in Europe and over time institutionalized its doctrine of love for fellow men by creating (and encouraging gifts for) monasteries, charitable hospitals, and colleges, all dedicated to serving God by providing for the poor.<sup>34</sup> By the sixth century and throughout most of the early Middle Ages in England, Catholic monasteries were the centers of practical charity, relieving poverty, tending the sick, and providing education.<sup>35</sup>

By the eleventh century, as feudalism became the dominant mode of social organization in England, landed nobles began to take on—at least in theory—responsibility for caring for their needy subjects in exchange for loyalty, agricultural labor, and a willingness to fight under the lord's banner in the period's endless private and public wars.<sup>36</sup> In the following centuries, cities, towns, and guilds also began to take a role in poor relief.<sup>37</sup> However, monasteries, with their Christian view of charity, remained the primary institutional vehicles for providing aid to the sick and poor from medieval times up until the Protestant Reformation.

## 2. The Origins of English Charity Laws

The thirteenth and fourteenth centuries in England were a time of transition in the law and culture of charity. Although most organized charity still took place under the aegis of the Church of Rome and its monasteries, budding medieval states began to intervene through the institution of the law. England's early legislative efforts were intended solely to control begging and prevent vagrancy, problems that were only beginning to appear on a significant scale.<sup>38</sup> A typical effort was the Ordinance of Laborers in 1349, which attempted among other things to force both laborers and the unemployed poor to remain within their home districts and to work for whoever would hire

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33. See Gladstone, *supra* note 7, at 30.

34. See Curti, *supra* note 15, at 342-43 (adding that during this time much of the charity was "impulsive, indiscriminate, and perfunctory").

35. E.M. Leonard, *The Early History of English Poor Relief* 4 (2d ed. 1965); Trattner, *supra* note 7, at 4; see Wagner, *supra* note 6, at 85 (adding that medieval monasteries were centers of radical thought and often at odds with the mother church).

36. Trattner, *supra* note 7, at 4. See generally Jonathan Sumption, *The Hundred Years War: Trial by Battle* (1990).

37. Leonard, *supra* note 35, at 7.

38. *Id.* at 3.

them.<sup>39</sup> It also limited private giving on the theory that so-called “promiscuous alms” would encourage sloth and licentiousness.<sup>40</sup> These restrictions were further elaborated in the Act of 1388, which not only forbade the movement of beggars and laborers but went a step further by requiring all commoners to obtain letters of permission before leaving their local districts.<sup>41</sup> Those caught without letters were to be placed in stocks, which seems a harsh punishment until compared to the abuse doled out to the English poor in the following centuries.<sup>42</sup>

Crude as they were, these early English acts contained seeds of future Anglo-American laws governing charity. They represented the first attempts to weed out able-bodied or “sturdy” beggars, who were considered unworthy of charity.<sup>43</sup> They also were harbingers of the growing belief that poverty was a personal failing that could justly be remedied by controlling and punishing the poor.<sup>44</sup>

As English authorities undertook these simple attempts to legislate against poverty and its effects, society’s definition of charity began to shift. Where it had once meant ecclesiastical attempts to purify men’s hearts by ministering to the needs of the poor, it now began to imply a sort of social engineering. For the first time, it appeared that the emerging nation-state might have a legitimate role in controlling poverty and, at least indirectly, administering charity. Thus began a long, slow process—one that continues to this day—of tugging charity away from its ecclesiastical roots.

### 3. Charity as Social Engineering

Histories of Anglo-American charity and the laws that regulate it often begin in the year 1601 with the passage of Queen Elizabeth’s Poor Laws and Statute of Charitable Uses.<sup>45</sup> But those laws were in reality a mere reflection and culmination of gradual, fundamental changes in the cultural and legal definition of charity that took place during the sixteenth century in England.<sup>46</sup> To pinpoint the origins of America’s present legal difficulties, we must go back a bit further than 1601, to the early and mid-1500s when two historic developments helped establish a new cultural and legal definition of charity.

The first was King Henry VIII’s (r. 1509-1547) disagreement with the Church of Rome over his desire to divorce Catherine of Aragon

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39. Trattner, *supra* note 7, at 8.

40. Leonard *supra* note 35, at 3; Trattner, *supra* note 7, at 7-8.

41. Leonard, *supra* note 35, at 5.

42. *See id.*

43. *Id.*

44. *Id.*

45. *See infra* notes 73-84 and accompanying text for a discussion of the Statute of Charitable Uses.

46. *See Gray, supra* note 28, at 43; Trattner, *supra* note 7, at 10.

and marry Anne Boleyn. When the Church of Rome, in the person of Pope Clement VI, refused to grant Henry's annulment and bless his second marriage, Henry responded in 1536 by establishing his own more compliant church, the Church of England, and seizing all ecclesiastical property in his domains, including the thousands of monasteries that formerly had ministered to the poor.<sup>47</sup> The recipients of Church of Rome properties, both ecclesiastical and lay, were generally bound by the terms of the Crown's grants to continue the charity work that had taken place on the property, but in practice these pledges were often ignored.<sup>48</sup>

The second, coincidental historical trend that helped sow the seeds of modern charity was the shift from feudal social organization to mercantile capitalism.<sup>49</sup> The mid-sixteenth century in England was a time of social and economic upheaval. To condense several centuries of gradual historical change into one paragraph, the wool production in Europe's Low Countries became a center of industrial development, and the feudal lords of England realized that they could create greater personal wealth by fencing, or "enclosing," their vast domains to create sheep pasturage rather than by maintaining leagues of peasants to cultivate the land and create agricultural surplus. The result of the so-called "enclosure movement" was to throw the peasants off of the land on which they subsisted, forcing many to migrate to urban centers where, not incidentally, mercantile industries were taking shape and looking for labor.<sup>50</sup> In the social dislocation caused by this economic transformation, many poor were left without land to grow crops or wages with which to buy food. Poverty and the social ills that attend it—vagrancy, begging, crime—skyrocketed and laws intended to manage or control poverty multiplied.<sup>51</sup>

Thus, in Henry VIII's England, poverty was increasing dramatically just as he was destroying the Catholic monasteries that acted as the nation's primary institutions of poor relief.<sup>52</sup> His Reformation swept

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47. David C. Hammack, *Introduction* to Making the Nonprofit Sector in the United States 3-4 (David C. Hammack ed., 1998) [hereinafter *The Nonprofit Sector*].

48. Gray, *supra* note 28, at 11.

49. Samuel Mencher, *Poor Law to Poverty Program: Economic Security Policy in Britain and the United States* 3 (1967) (arguing that the origins of modern philanthropy are in the rise of mercantilism in the mid-sixteenth century); Curti, *supra* note 15, at 342 (arguing philanthropy grew from the death of feudalism, the rise of cities and a middle class, dislocation of population due to the enclosure movement, and the Reformation itself); see also Hammack, *supra* note 47, at 9.

50. See Mencher, *supra* note 49, at 9. Most of those who found wage labor continued in poverty. It was an accepted tenet of the classical economic theory of the early mercantile period that wages be kept at subsistence levels, not (at least in theory) to maximize profits, but rather to prevent laborers from attempting to accumulate capital, thereby rising above their station and disrupting the hierarchical social system that God had ordained.

51. See Leonard, *supra* note 35, at 11-13; see also Gray, *supra* note 28, at 3-6 ("The sheep farmers and enclosers acted promptly, the habits of a people alter but slowly.").

52. See Gray, *supra* note 28, at 9.

away the church-centered welfare system, and attempted to fill the void with a more secular brand of philanthropy and state regulation.<sup>53</sup> Charity, which formerly had been grounded in the Roman Catholic values of love and compassion, mercy and forgiveness, now also would be controlled by the values of the state and its state-sponsored religion.<sup>54</sup> Given the economic trends the state was being forced to grapple with, its values were focused on creating social order, not alleviating suffering out of a sense of love and compassion and a desire to please the Lord.<sup>55</sup> At the same time, the state-sponsored Protestantism that was taking hold in England placed greater emphasis than the Church of Rome on asceticism, self-reliance, the primacy of work, and the notion that poverty was a sign of God's disfavor.<sup>56</sup> For charity and for the poor that relied on it, significant changes were in the offing.

#### 4. The Evolving Law of Charity

England's intervention in the realm of charity took place gradually over more than two hundred years and included a long series of edicts and parliamentary acts. For the sake of brevity, we will condense that history into a few pages, focusing particular attention on those developments that laid the foundation for our current, divided American cultural and legal definition of charity.

The first of Henry's acts that established the template for later charity law was a 1531 Act which was intended to address the growing problem of poverty.<sup>57</sup> It commanded sheriffs and justices of the peace in the realm to identify the deserving poor in their districts and issue to them what amounted to licenses to beg within limited geographic limits. According to this Act, the able-bodied who sought alms were to be punished by whipping, and those who gave alms to the able-bodied were to be fined.<sup>58</sup> By its own terms, the Act was intended to limit the number of beggars, not to provide relief to the poor.

The first act failed at both relieving poverty and controlling its consequences, and thus led to the second significant charity act of Henry's reign, which commanded his subjects to, among other things, put the "sturdy poor" to work and bind vagrant children into apprenticeships.<sup>59</sup> As to those who were legitimately "impotent," a system was established by which alms were to be placed in a common box at each parish of the Church of England and then distributed by

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53. Gladstone, *supra* note 7, at 37-38.

54. *See id.* at 38.

55. *See* Gareth Jones, *History of the Law Of Charity 1532-1827*, at 10 (1969).

56. Gurin & Van Til, *supra* note 2, at 5; *see* Mencher, *supra* note 49, at 6 (arguing that during the mercantile period work became man's duty before God).

57. 22 Hen. 8, c. 12 (1531) (Eng.); *see supra* notes 49-51 and accompanying text.

58. Leonard, *supra* note 35, at 54; *see also* Gray, *supra* note 28, at 32.

59. 27 Hen. 7, c. 25 (1536) (Eng.); *see also* Leonard, *supra* note 35, at 54-56.

parish authorities to the truly needy.<sup>60</sup> Again, private alms were forbidden for fear they would encourage idleness and vagrancy.<sup>61</sup> This second act introduced into the Anglo-American law of charity the idea of putting the poor to work; however, it gave no guidance as to how that task was to be carried out, and for that reason was largely ineffectual. Still, when taken together, Henry's two acts represented the first time the state had taken a significant role in administering charity or poor relief<sup>62</sup> and, more important for our purposes, it implanted the notion in the Anglo-American legal and cultural tradition that proving or requiring work was a valid response to poverty and suffering.

If Henry's reign introduced the notion that the state should use a stick as the primary means of addressing poverty, the idea was stretched to extremes during the brief reign of Henry's son, Edward VI (r. 1547-1553). Finding that Henry's strictures had not stemmed the tide of poverty and begging, in 1547, the first year of young Edward's reign, an act was passed providing for, among other things, the enslavement of sturdy beggars for a term of two years.<sup>63</sup> If the enslaved subjects ran away and were captured, they would be enslaved for life.<sup>64</sup> The sons of vagrants could be removed from their parents and apprenticed until they reached the age of twenty-four, daughters until the age of twenty.<sup>65</sup> The enslavement laws lasted for only two years, at which time whipping was reintroduced, but by that time it had been well established that the state's intervention in the realm of charity would be guided by principles other than compassionate benevolence.<sup>66</sup>

As the problems of poverty and vagrancy grew and social stability was further threatened, legislative acts multiplied. During the reign of Elizabeth I (r. 1558-1603) the Act Concerning Poverty was horribly harsh in its efforts to suppress vagrancy.<sup>67</sup> Penalties under the Act

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60. See Trattner, *supra* note 7, at 9.

61. Leonard, *supra* note 35, at 55 (noting that noblemen, abbots, and friars were exempted from the limits on almsgiving).

62. See *id.*; see also Mencher, *supra* note 49, at 26.

63. Leonard, *supra* note 35, at 56-57 (citing 1 Edw. 6, c. 3 (1547) (Eng.)).

64. *Id.* at 56.

65. *Id.*

66. See *id.* at 56-57.

67. 14 Eliz., c. 5 (1572) (Eng.); see also Leonard, *supra* note 35, at 70. Today, this Act is most often referred to because its efforts to define the problem of poverty are amusing to contemporary ears. For example, it famously included within its definition of vagrants "scholars of Oxford and Cambridge who beg without being licensed by Chancellor or Vice-Chancellor." *Id.* It was also notable for our purposes because of the controversy it caused by proscribing travel by "minstrels, bearwards, etc." *Id.* (internal quotation marks omitted). After contentious debate, the House of Commons worked out a compromise that permitted this class to wander but only after obtaining a license from two separate justices of the peace. It was an early example of an Anglo-American legislative body having to choose between poverty regulation and

included whipping and boring through the ear for the first offense, conviction of a felony for the second offense, and, with certain exceptions, death for the third offense.<sup>68</sup>

Elizabeth's Act of 1572 was also remarkable in that it represented a first attempt by the English government to establish a comprehensive system of poor relief. The law commanded justices of the peace to create registries of their districts' deserving poor and identify habitations that could accommodate them. They also were to weed out poor strangers and send them to their home districts. Once the list of legitimate local poor was completed, local officials were to estimate the expense of aiding them, and tax the district's inhabitants accordingly.<sup>69</sup> By the time of this act, the state had clearly abandoned the notion that giving to the poor should be voluntary and for the metaphysical benefit of the donor. Charity had come over to the state, and now would be characterized by social engineering, compulsion, and work.<sup>70</sup>

The Elizabethan laws that followed represented elaborations on the general theme of forcing work upon the poor. The Act of 1575<sup>71</sup> offered a first, tentative solution to the problem of providing work for the "sturdy poor" rather than simply whipping, jailing, or enslaving them. It required each city and town to provide a stack of wool, hemp, iron, or other raw material for labor for the idle. It also required the establishment of houses of correction where those unwilling to work could be sent.<sup>72</sup>

Such was the state of English law when the Statute of Charitable Uses and the Poor Laws were debated and passed in 1601. The Poor Laws were no more than a summation of the cultural and legal developments represented by the various acts of the previous century, discussed above.<sup>73</sup> The crux was to enable public relief for the deserving poor, largely by forcing them to work.<sup>74</sup>

The Statute of Charitable Uses, passed in the same year, was intended to enable private charitable efforts by legally defining the concept of charity. The Statute's most recognizable and oft-quoted feature, its preamble, listed the charitable activities, or uses that the law would accept.<sup>75</sup> They included:

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commerce and coming down, at least largely, on the side of commerce. We shall see this legislative choice repeated later in mid-1800s America.

68. Leonard, *supra* note 35, at 70.

69. *Id.* at 71.

70. *See id.* at 72.

71. 18 Eliz., c. 3 (1575) (Eng.).

72. *Id.*

73. *Cf.* Gray, *supra* note 28, at 43; Trattner, *supra* note 7, at 10.

74. *See* Trattner, *supra* note 7, at 11.

75. Gladstone, *supra* note 7, at 40 (arguing the preamble to the Statute of Charitable Uses "exercised a profound effect on later development[s] of the legal meaning of charity").

[S]ome for relief of aged, impotent and poor people, some for maintenance of sick and maimed soldiers and mariners, schools of learning, free schools, and scholars in universities, some for repair of bridges, ports, havens, causeways, churches, sea-banks, and highways, some for education and preferment of orphans, some for or towards relief, stock or maintenance for houses of correction, some for marriages of poor maids, some for supportation, aid and help of young tradesmen, handicraftsmen and persons decayed, and others for relief or redemption of prisoners or captives, and for aid or ease of any poor inhabitants concerning payments of fifteens, setting out of soldiers and other taxes; . . .”<sup>76</sup>

The Statute of Charitable Uses remained good law for well over a century<sup>77</sup> and to this day is considered by many as the starting point of the modern Anglo-American law of charity.<sup>78</sup> As such, it is worthwhile to examine some of its features.

First, the language of the Statute made plain that spirituality and religion were no longer at the heart of the legal definition of charity. The only glancing mention religion received was in the “repair of . . . churches.”<sup>79</sup> It was not until many decades later, as the turmoil of the Reformation faded into memory, that the English common law definition of charity evolved to encompass religious uses.<sup>80</sup>

The preamble to the Statute also confirmed that by 1601 charity had turned sharply toward social engineering. It encouraged charitable donors to consider the building of bridges, roads, and schools as legitimate charitable purposes. Charity had evolved from a spiritually charged activity to a more secular one, defined most broadly by the

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76. 43 Eliz., c. 4 (1601) (Eng.).

77. For purposes of our inquiry, we need not trace English legal developments beyond the Statute of Charitable Uses. However, for the curious, we can summarize by saying that by 1736 there was a popular reaction in England against the steady increase of charitable land holdings that developed under the Statute. Parliament in that year passed the Mortmain Act, which, in essence, rendered most charitable bequests void and gutted the Statute. After more than a century of confusing and contradictory legal developments, Lord McNaughten brought some order back to the law of charity by offering a new legal definition that was essentially a summary of and slight elaboration upon the Statute. He declared that

“Charity” in its legal sense comprises four principal divisions: trusts for the relief of poverty; trusts for the advancement of education; trusts for the advancement of religion; and trusts for other purposes beneficial to the community, not falling under any of the preceding heads. The Trusts last referred to are not the less charitable in the eye of the law, because incidentally they benefit the rich as well as the poor, as indeed, every charity that deserves the name must do either directly or indirectly.

Comm’rs for Special Purposes of the Income Tax v. Pemsel, 1 A.C. 531, 583 (H.L. 1891) (Lord McNaughten’s judgment).

78. See David C. Hammack, *The Statute of Charitable Uses, in Making the Nonprofit Sector in the United States*, *supra* note 47, at 5-6.

79. 43 Eliz., c. 4.

80. See *Pemsel*, 1 A.C. at 531 (Lord McNaughten’s judgment) (including religion within the legal definition of charity).

“public benefit.”<sup>81</sup> This was the beginning of the view, which later would become a central tenet of Anglo-American charity law, that donations for “public benefit” activities would be charitable, even if that benefit was not focused on the poor and distressed.

Elizabeth’s Statute and Poor Laws also represented the view, which had developed over the preceding centuries in England, that poverty was caused by immorality and sloth, and that it could be addressed by requiring the poor to work. The various acts leading up to the 1601 legislation had vacillated over the proper level of cruelty with which to treat vagrants and beggars, but these vacillations were merely over degree. By 1601, there was no disagreement over the fact that some were deserving of charity while others—chiefly those who were considered “sturdy”—could rightly be left to starve if they refused to work.<sup>82</sup>

It is particularly significant for our purposes that the Statute’s strong legal and cultural predilection for work as a response to poverty included the “aid and supportation of young tradesmen, [and] handicraftsmen.”<sup>83</sup> Expressed in modern terms, the 1601 English law of charity approved of introducing the poor to the market and encouraging them to work their own way out of poverty.<sup>84</sup> This notion of commercial activity as a tool for alleviating poverty later took root in America and, as we will discuss below, migrated to a central position in the American culture and law of charity.

Before departing England and continuing our inquiry on the shores of the New World, it is important to emphasize two aspects of the history of late medieval charity that have reverberated through the centuries. First, as a result of the Reformation and the poverty laws that were passed under the reigns of Henry VIII, Edward VI, and Elizabeth I, charity became identified with work and enterprise. Second, although the pre-Reformation vulgar understanding of charity began to give way to the social engineering view, the older version never entirely disappeared. The Reformation and the various legislative acts of late medieval England secularized charity and reformed it into a mechanism for controlling poverty and pauperism, but charity never completely shed its compassionate, spiritual underpinnings. In spite of the broadening definition of charity, men and women were still motivated to engage in charitable works and

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81. See Gladstone, *supra* note 7, at 47 (arguing the Statute of Charitable Uses made “public benefit” the key to the legal meaning of the term charity); Lieber, *supra* note 12, at 734.

82. See Mencher, *supra* note 49, at xvi, 23, 33.

83. 43 Eliz., c. 4 (1601) (Eng.).

84. See Gray, *supra* note 28, at 18.



leave charitable bequests in hopes of making right with their creator and securing for themselves a comfortable place in the afterlife.<sup>85</sup>

B. *Charity Comes to America: From Cotton Mather to Scientific Philanthropy, Work Becomes Charity's Dominant Ethos*

1. Early Influences on American Charity: The Self-Help Tradition and Ascetic Protestantism

Although it was clear from the start that the colonists would carry their charitable traditions along with them from England to the New World,<sup>86</sup> it was just as clear that circumstances in the colonies would lead to a particularly American version of charity, one that would stress to an even greater extent than in England individual responsibility, the primacy of work and, eventually, high tolerance for blending charity and private enterprise.

Two aspects of life in the New World shaped the development of American charity. First, New World communities came into existence before strong governments. In America, if public needs, including the needs of the destitute, were to be addressed at all, the communities themselves would have to take care of them.<sup>87</sup> As the colonies developed, and later as the American frontier opened up, the tradition of self-help and caring for one's own—whether or not it happened in fact—became a central and celebrated part of our cultural narrative.<sup>88</sup>

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85. See Gladstone, *supra* note 7, at 170 (arguing “[c]harity in this broad sense—‘love thy neighbour as thyself’—remains a powerful if often unconscious influence even in these secular times . . . there abides a certain fascination and respect for the principle of equal and unconditional concern for the welfare of every fellow human being”); Gray, *supra* note 28, at vii, 41-42 (arguing the old Judeo-Christian motivations for charity did not disappear with the Reformation).

86. See Trattner, *supra* note 7, at 30 (noting that by 1691 Boston had four full-time overseers of the poor); Fishman, *supra* note 4, at 623 (some of the first state constitutions drawn up after the Revolution, including Massachusetts’s, provided “[i]t shall be the duty of legislatures and magistrates, in all future periods of this Commonwealth . . . to countenance and inculcate the principles of humanity and general benevolence, public and private charity . . . and all social affections, and generous sentiments among the people”); Lieber, *supra* note 12, at 735 (noting that, in 1620, before landing at Plymouth, forty-one passengers on the Mayflower signed the Mayflower Compact “expressing their commitment to provide for the common good”).

87. See Lieber, *supra* note 12, at 734-35. In a related point, because the colonies lacked the feudal paternalism that colored England’s sense of social responsibility, the poor of the New World were—to a degree even greater than in England—left out in the cold to either find work or starve. See Mencher, *supra* note 49, at 40-41.

88. See Lieber, *supra* note 12, at 735. A close corollary of this celebration of self-help was the central position of volunteerism in the American culture of charity. See Gurin & Van Til, *supra* note 2, at 6. While opinions vary over whether the combination of volunteerism and self-help are an effective strategy for dealing with social needs, there can be little doubt that they lie at the heart of Americans’

Second, the colonists' ascetic version of Protestantism had a strong impact on charity in the New World. Although the various sects that populated the colonies did not always agree on questions of religious doctrine,<sup>89</sup> they shared beliefs about poverty and society's role in alleviating it. Like pre-Reformation Christians, the Protestants of the New World believed that misery and want were part of God's plan and thus inevitable.<sup>90</sup> From there, however, their views diverged. In contrast to pre-Reformation Christianity's emphasis on communing with God by showing indiscriminate compassion toward the poor, the Protestants of the New World tended toward the belief that wealth was proof of goodness and selection by God, while poverty was evidence of the opposite.<sup>91</sup> Each man was his own master under God,<sup>92</sup> and each person's moral obligations were owed directly to Him rather than to fellow man. Under these guiding beliefs, the religious significance of charity faded somewhat.<sup>93</sup>

In keeping with their beliefs about individual responsibility under the eyes of God, the colonists believed that the state and society had limited responsibility to provide for the welfare of individuals.<sup>94</sup> These views were reflected in the writings of the great proponents and spokespersons of American charity. Cotton Mather, for example, who preached to the Massachusetts Bay Colony in the seventeenth century, was the main colonial exponent of "do-goodism."<sup>95</sup> He held that all highborn individuals had a responsibility to undertake voluntary acts of charity, not as a means of salvation, but as a religious obligation owed to the God who had already selected them for salvation.<sup>96</sup> He vigorously inveighed against unwise bestowal of alms lest they should encourage indolence on the part of the recipients.<sup>97</sup> Mather is remembered for scolding nostrums that helped define core concepts of American charity. Notably, he insisted that God intended the poor to work and that those who were able but refused should be left to starve.<sup>98</sup>

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conception of charity. See Gary N. Scrivner, *100 Years of Tax Policy Changes Affecting Charitable Organizations*, in *The Nonprofit Organization: Essential Readings*, *supra* note 13, at 127 (arguing that "[c]itizens combating problems and reaching solutions on a collective basis, in associations, is inherent in the very nature of American societal structure").

89. See David C. Hammack, *Colonial Reality: Religious Diversity, in The Nonprofit Sector*, *supra* note 47, at 37.

90. Trattner, *supra* note 7, at 38.

91. Mencher, *supra* note 49, at 43.

92. *Id.* at 62.

93. See *id.*

94. See *id.* at 40.

95. See Bremner, *supra* note 22, at 11.

96. See Trattner, *supra* note 7, at 12.

97. See Bremner, *supra* note 22, at 12-14.

98. See Trattner, *supra* note 7, at 22.

Benjamin Franklin's writings also exerted influence over the development of American charity. His historical legacy has become closely identified with volunteerism and self-help, partly as a result of the many voluntary organizations he formed in Philadelphia, including the nation's first volunteer firehouse and the Junto Society, which, among other things, helped young men establish themselves in private enterprise.<sup>99</sup> Franklin was harshly critical of social welfare systems that provided handouts to the poor. Visiting England in 1776, he said that their system, which was still based on the Elizabethan Poor Law, caused the poor to be "idle, dissolute, drunken and insolent."<sup>100</sup> Franklin introduced a more secular tinge to Mather's do-good gospel, nudging to the center of American charity the notion that industry and hard work were the only legitimate responses to want, and that charity should be limited to driving the poor out of poverty.<sup>101</sup>

After the Revolution, American charity continued to focus on finding work for the poor, but there was a slight change in the philosophical justification of why this was the proper course. The Enlightenment, with its belief in rationality and boundless progress, wore away the grim determinism of Calvinist Protestantism and pushed aside the notion that misery and want were inevitable. It challenged the American public to do something to help the poor.<sup>102</sup> At the same time, Enlightenment thinking supported the idea—by now a settled aspect of the American charitable tradition—that the poor were responsible for their own plight.<sup>103</sup> After all, in a land rich in natural resources and opportunity, what other than sloth and moral decrepitude could explain an individual's failure to prosper?<sup>104</sup>

The result was a vast increase in nineteenth-century America of the number of organizations devoted to combating poverty, with most of them determined to carry out their missions by offering spiritual counseling and, foremost, by putting people to work.<sup>105</sup>

## 2. The Era of Friendly Visitors and Scientific Philanthropy

The mid-nineteenth century was the beginning of the era of the "friendly visitor" or "friendly advice" in America that offered the

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99. See generally Benjamin Franklin, *Autobiography: Recollections of Institution-Building, 1771-84*, in Hammack, *The Nonprofit Sector*, *supra* note 47, at 71, 74-75.

100. Mencher, *supra* note 49, at 96.

101. Bremner, *supra* note 22, at 17.

102. Trattner, *supra* note 7, at 38.

103. *Id.* at 54.

104. See Mencher, *supra* note 49, at 144; Trattner, *supra* note 7, at 43 (arguing the tendency to equate charity with work was encouraged by the exploration and settling of the American West, which was propelled by a cultural creed of independence, self-help, and personal achievement).

105. See Mencher, *supra* note 49, at 144, 148; Trattner, *supra* note 7, at 43; Wagner, *supra* note 6, at 52.

poor “no alms, but sympathy and counsel.”<sup>106</sup> In the view of the friendly visitors, since poverty was a personal failing that resulted from moral weakness, the solution was a friend from the middle class who would instruct the unfortunate in the ways of clean, upright, prosperous living.<sup>107</sup> The friendly visitors were in the business of building character, not necessarily relieving need.<sup>108</sup> Money was not to change hands.<sup>109</sup>

Josephine Shaw, who in the late nineteenth century was famous as a fierce proponent of the concept of friendly visiting, expressed the visitors’ fixation on work when she declared that “the world [is] made of two classes: workers and idlers.”<sup>110</sup> She and the friendly visitors would provide structure and guidance for the former, while the latter, as Cotton Mather preached in colonial days, could be left to starve.<sup>111</sup>

The stingy benevolence<sup>112</sup> of the friendly visitor movement and general focus on work as the core of American charity and philanthropy was interrupted during the Civil War years. Warnings about unwise giving of promiscuous alms were forgotten in the face of widespread suffering and need.<sup>113</sup> During the war the central government became more involved in poverty relief and the experience encouraged the view that its presence was necessary to achieve meaningful social welfare.<sup>114</sup> However, the wartime generosity brought increased public debt and higher taxes, which caused a backlash of hostility to public poor relief in the postwar years.<sup>115</sup>

The late nineteenth and early twentieth centuries saw the rise of so-called “scientific philanthropy.” Aside from its name, there was nothing particularly new about scientific philanthropy. Benjamin Franklin had preached a similar message 150 years earlier.<sup>116</sup> However, because the “scientific” approach was espoused by the omnipotent robber barons of the day, it became the dominant ethos in turn-of-the-century and early-twentieth-century American charity.

“Rags-to-riches” had become a popular cultural narrative in the United States as men like Andrew Carnegie and John D. Rockefeller amassed fortunes that would have been unimaginable a generation

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106. Trattner, *supra* note 7, at 69.

107. Bremner, *supra* note 22, at 99-100 (arguing the “friendly visitor” notion was founded on a conviction of superiority).

108. *Id.* at 100.

109. See Wagner, *supra* note 6, at 48.

110. Bremner, *supra* note 22, at 97.

111. See *supra* notes 94-98 and accompanying text.

112. See Trattner, *supra* note 7, at 100 (arguing the friendly visitors were stingy in that they ignored empirical evidence that showed that poverty resulted from accidents, sickness, and market fluctuations, not from indolence).

113. Bremner, *supra* note 22, at 75; Trattner, *supra* note 7, at 77.

114. Trattner, *supra* note 7, at 81.

115. Bremner, *supra* note 22, at 76-88.

116. See *id.* at 89-104; see also *supra* notes 99-101 and accompanying text.

earlier.<sup>117</sup> Steeped in Social Darwinism, they believed it was a waste of time to defy the evolutionary process by supporting the weaker of the species,<sup>118</sup> those who in earlier generations would have been referred to as the “undeserving,” “idle,” or “sturdy” poor. Although Carnegie and his brethren recognized that the state bore some responsibility for caring for the destitute and helpless, they firmly believed that the philanthropy of the wealthy should focus on the able and the industrious.<sup>119</sup> Carnegie himself was contemptuous of sentimental almsgiving,<sup>120</sup> specifically rejecting the notion that anything valuable could be accomplished by imitating the life or methods of Christ,<sup>121</sup> and believing that “the best means of benefiting the community is to place within its reach the ladders upon which the aspiring can rise.”<sup>122</sup> In the view of Carnegie and the other scientific philanthropists, rationality, efficiency, foresight, and planning were middle-class virtues that had proved their worth in the realm of for-profit enterprise, and now it was time to apply those same virtues in the realm of charity.<sup>123</sup> In an articulation of charity that would resurface forcefully a century later, Carnegie demanded to know whether proposed recipients of aid would make good investment vehicles.<sup>124</sup>

Along with the rise of scientific philanthropy came a related but less noticed trend in American charity. To a degree that had not previously been evident, the idea of engaging in and encouraging commerce was accepted as part of a broadening definition of charity.<sup>125</sup> In many states, there developed a high tolerance for business methods and commercial strategies among charities.<sup>126</sup> For example, an 1888 tort case from Pennsylvania addressed the question of whether a fire patrol that benefited the public but was funded and motivated by the commercial interests of fire insurance companies could be considered charitable. The Supreme Court of Pennsylvania began its analysis by examining a traditional definition of charity: “It is whatever is given for the love of God, or for the love of your

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117. Trattner, *supra* note 7, at 95.

118. See Bremner, *supra* note 22, at 103; see also Peter Dobkin Hall, *Inventing the Nonprofit Sector and Other Essays on Philanthropy, Volunteerism, and Nonprofit Organizations* 121 (1992) (arguing that modern philanthropy was born when Social Darwinism, industrial wealth, and academic expertise came together in the 1890s).

119. Bremner, *supra* note 22, at 105-21; see also Charles T. Clotfelter & Thomas Ehrlich, *The World We Must Build, in Philanthropy and the Nonprofit Sector in a Changing America*, *supra* note 16, at 501.

120. Bremner, *supra* note 22, at 108.

121. *Id.* at 107.

122. Hall, *supra* note 118, at 45.

123. See Trattner, *supra* note 7, at 94.

124. Hall, *supra* note 118, at 118.

125. See Norman I. Silber, *A Corporate Form of Freedom: The Emergence of the Modern Nonprofit Sector* 47 (2001).

126. *Id.* at 45.

neighbor, in the catholic and universal sense; given from these motives, and to those ends, free from the stain or taint of every consideration that is personal, private, or selfish."<sup>127</sup> The court concluded, however, that such Christian purity of heart was not a necessary element of American charity, and that the fire insurance companies' commercial motivations were beside the point, so long as their activity was benefiting the public at large.<sup>128</sup>

In an oft-cited case from 1899, the Supreme Court of New Jersey was asked to decide whether a home for aged and disabled men qualified for property tax purposes as charitable where it paid for its operations—including a mortgage note and superintendents' salaries—by purchasing firewood, requiring residents to turn it into kindling, and then selling it for a profit.<sup>129</sup> The court had no trouble finding that "[w]here the objects and purposes of the institution are wholly charitable, with no element of private gain, the receipt of compensation from those who enjoy the benefits do not affect its charitable nature."<sup>130</sup>

In Massachusetts, the Supreme Judicial Court was called upon in 1905 to decide whether a home for young workingwomen was charitable where it rented its rooms to the young women at moderate cost.<sup>131</sup> The court pointed directly to the "supportation, aid and help of young tradesmen" language in the preamble to the Statute of Charitable Uses<sup>132</sup> in deciding that launching young women into employment was a charitable purpose, even where they were paying nominal rent to cover the costs of the charitable operation.<sup>133</sup>

Beginning in the late 1800s and continuing through the roaring decade of the 1920s it became increasingly acceptable in the eyes of

127. *Fire Ins. Patrol v. Boyd*, 15 A. 553, 554 (Pa. 1888).

128. *See id.* at 555-56; *see also* *Trs. of Ky. Female Orphan Sch. v. Louisville*, 36 S.W. 921, 923 (Ky. 1896) (charity does not lose its character as such if it receives revenue from the recipients of its bounty sufficient to keep it in operation); *Contributors to Pa. Hosp. v. Delaware County*, 32 A. 456, 457 (Pa. 1895) (holding that a convalescent farm used by a hospital is charitable and thus exempt from property tax even though the farm produces a profit for the hospital); *Trs. of Acad. of Protestant Episcopal Church v. Taylor*, 25 A. 55, 57 (Pa. 1892) (holding that the definition of "charity," which had been steadily broadening, now included a school open to the public that charged students enough to maintain itself in operation); *House of Refuge v. Smith*, 21 A. 353, 354 (Pa. 1891) (holding juvenile correction home charitable for property tax purposes even though residents work at jobs that produce some income for organization).

129. *Patterson Rescue Mission v. High*, 44 A. 974, 974-75 (N.J. 1899).

130. *Id.* at 975.

131. *Franklin Square House v. Boston*, 74 N.E. 675, 675 (Mass. 1905).

132. *See supra* note 76.

133. *Read v. Tidewater Coal Exch., Inc.*, 116 A. 898 (Del. Ch. 1922) (finding a trade association formed to move coal efficiently through tidewater ports charitable); *Franklin Square*, 74 N.E. at 676; *see also* *House of the Good Shepherd of Omaha v. Bd. of Equalization (In re House of the Good Shepherd of Omaha)*, 203 N.W. 632 (Neb. 1925) (ruling a laundry that produces considerable revenue at a home for fallen women is charitable).

judges and policymakers for charity and enterprise to grow toward one another.<sup>134</sup> This trend slowed with the onset of the Great Depression,<sup>135</sup> but as we shall see, arose again in modern times and has moved toward the core of American charity.

### 3. The Persistence of Charity as Love

We must once again pause to note that although the story of charity in the New World was one of increasing insistence on work as a solution for poverty and increasing acceptance of commerce as a tool of charity, the old-world, pre-Reformation view of charity as Christian love was also transported to America. During times of widespread crisis and hardship, most notably the Civil War and the Great Depression, compassion-based charity and “promiscuous almsgiving” came back into style, if only temporarily.<sup>136</sup> Even in times of peace and relative prosperity there was a consistent hum of criticism of scientific philanthropy and the “work or starve” social engineering conception of charity from clergy who insisted that Christ demanded uncalculating brotherly love from his servants.<sup>137</sup> In their view, the spiritual aspects of charity, including the creation of a community of feeling and a set of human bonds, were as significant as the charitable service itself.<sup>138</sup>

Even outside the church there were signs that the older, pre-Reformation, vulgar notions of charity were not completely swept aside by the headlong rush to friendly visiting and scientific philanthropy. For example, in the late 1800s, Clara Barton’s work forming the Red Cross focused on relieving suffering. She had little interest in reforming charity or philanthropy to conform to Enlightenment or Social-Darwinist views.<sup>139</sup>

Likewise, the Settlement House movement that grew up around Jane Addams at the turn of the twentieth century was largely a negative reaction to the primacy of the social engineering, emotionally and spiritually sterile “friendly visitor” movement and “scientific philanthropy.”<sup>140</sup> The goal of that movement was to address poverty and its conditions, which alone did not distinguish it from “friendly visiting.” However, its doctrine and its methods were steeped in spirituality and included goals of forming spiritual bonds and a sense

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134. See Silber, *supra* note 125, at 47.

135. See *id.*

136. See *supra* notes 113, 135 and accompanying text.

137. See Hall, *supra* note 118, at 125.

138. *Id.* at 127.

139. See Bremner, *supra* note 22, at 90.

140. See Trattner, *supra* note 7, at 163. See generally Jane Addams, *Twenty Years at Hull-House* (1910).

of universal brotherhood between people of different stations.<sup>141</sup> Jane Addams herself proudly admitted that the Settlement House movement was based on spirituality and emotion as much as conviction.<sup>142</sup>

To take another, somewhat later example, the Catholic Worker movement, founded by Dorothy Day in the early 1930s, focused on poverty but clung always to a mission of doing God's work by building a spiritual community that included both the poor and the powerful.<sup>143</sup>

### C. American Charity from the Great Depression to Ronald Reagan

During the Great Depression, alms to the poor and distressed again became acceptable—as they had during the Civil War—in the face of suffering that was so widespread it could not be explained as the result of indolence or immorality.<sup>144</sup> Faced with the colossal need, it also became evident to all that private philanthropy could not cope by itself, notwithstanding Herbert Hoover's insistence to the contrary.<sup>145</sup> It thus became a broadly accepted view during the Depression that private and public charity should both be encouraged and work in concert.<sup>146</sup>

This attitude of cooperation between government and private actors helped fuel an explosion of charitable activity within the nonprofit sector,<sup>147</sup> particularly after 1960.<sup>148</sup> A trend developed in which the government used private charities to carry out its ambitious New Deal, and later Great Society, social welfare plans.<sup>149</sup> The trend continued into the 1970s, partly because of Americans' general

141. See Bremner, *supra* note 22, at 114 (noting that, like the “friendly visitors,” the Settlement House movement was based on class assumptions that the poor could be ennobled by association with decent Americans of higher class and education); see also Trattner *supra* note 7, at 183 (noting that the Settlement House movement, in spite of its emotional and spiritual origins, included an emphasis on empirical research, which ultimately helped dispel the notion that poverty was caused by immorality, and helped demonstrate that intervention by the state could relieve suffering. Many meaningful labor reforms, including child labor laws, grew out of the Settlement movement).

142. See Bremner, *supra* note 22, at 114.

143. See generally Dorothy Day, *The Long Loneliness: The Autobiography of Dorothy Day* (1952).

144. See Bremner, *supra* note 22, at 140; Comm'n on Private Philanthropy & Pub. Needs, *supra* note 2, at 92 (noting “[t]he Depression . . . shattered the myth that private charity could tide the deserving poor over bad times”); Wagner, *supra* note 6, at 66-67.

145. Trattner, *supra* note 7, at 276-77.

146. *Id.* at 214.

147. Hall, *supra* note 118, at 62-63.

148. Silber, *supra* note 125, at 143; see Bremner, *supra* note 22, at 201.

149. Kirsten A. Grønberg & Lester M. Salamon, *Devolution, Marketization, and the Changing Shape of Government-Nonprofit Relations, in The State of Nonprofit America*, *supra* note 2, at 452 (arguing that most of the Great Society programs of the 1960s and 1970s operated with and through nonprofits).



distrust of government as a result of Vietnam and Watergate, partly because of a growing societal unhappiness with what was considered a government-caused “welfare mess.”<sup>150</sup>

The new federalism that developed, in part to respond to this general air of distrust, included Title XX of the Social Security Amendments of 1974, which allowed states to use federal money to fund whatever social services they thought appropriate.<sup>151</sup> State and local governments rapidly expanded the use of “purchase of service agreements” under which they paid private charities to carry out state social welfare policy.<sup>152</sup>

This trend had an important formative effect on modern American charity. One change, mentioned above, was the rapid expansion in the number of nonprofit charities.<sup>153</sup> Another was an enormous increase in the complexity of the charitable nonprofit sector. As governments, the federal government in particular, became more important sources of support for charitable nonprofits, they attached regulations of Byzantine complexity to the grant of funds. Charities were forced to expand their organizational capacities and technology just to keep pace with government demands. By the 1980s, the organizational technology of voluntary action, once fairly simple and manageable, had by some accounts become a monopoly of the articulate and highly educated.<sup>154</sup> For the first time in history, it seemed that a successful manager of a charitable organization needed to have an MBA or law degree just to understand the applicable government regulations.<sup>155</sup>

The years of the Reagan administration marked a new era in charity, one that ultimately pushed the entire charitable sector in the direction of the free market. There were two main causes of this shift: First, the federal government under Reagan cut back on funds going to charitable organizations; second, those funds that were earmarked for charity were doled out using the supply-side schemes that the administration applied to all social problems.

In earlier periods of American history, widespread economic hardship usually had given rise to an expansion of the charitable sector and a governmental and cultural support for funding charities that addressed the suffering.<sup>156</sup> The Reagan years, however, were marked by steep cuts in federal expenditures, including cuts in funds

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150. Bremner, *supra* note 22, at 201.

151. *Id.* at 202.

152. *Id.*

153. *See supra* notes 147-48 and accompanying text.

154. *See Hall, supra* note 118, at 8.

155. Charity workers in the United States had begun to seek professional status in the early 1900s, around the time the academic disciplines of social work and sociology were coming on the scene. Bremner, *supra* note 22, at 109; Trattner, *supra* note 7, at 234.

156. *See supra* notes 113, 135 and accompanying text.

going to charitable nonprofit organizations, during times of recession and mounting unemployment.<sup>157</sup> The Reagan administration cut the federal government with evangelical zeal and rhetorically encouraged the charitable nonprofit sector to take up the slack, but at the same time it worked to cut government money going to that sector and to reduce incentives for individuals and corporations to donate to it.<sup>158</sup> Under these conditions, many charitable nonprofit organizations failed,<sup>159</sup> and those that survived did so by resorting increasingly to entrepreneurial, market-oriented strategies.<sup>160</sup> The American law and culture of charity had long ago begun permitting commercial activity in support of charity,<sup>161</sup> but during the Reagan administration, for the first time in U.S. history, law and policy converged to compel charities to engage in commerce to survive.

Scarce funding was not the only factor pushing nonprofit organizations toward the market. During the Reagan administration many of the funding programs for social services were converted, in accordance with the administration's supply-side preferences, from grants and contracts for the benefit of charitable organizations to vouchers and tax expenditures that channeled the increasingly scarce available resources to the consumers of social services rather than the

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157. Bremner, *supra* note 22, at 207.

158. Hall, *supra* note 118, at 80; *see also* Lester M. Salamon, *Nonprofit Organizations: The Lost Opportunity*, in *The Nonprofit Organization: The Essential Readings*, *supra* note 13, at 114 (arguing that Reagan had an opportunity to forge stronger links with the nonprofit sector but failed and instead relied on exhortation and on the assumption that his economic program would suffuse the country with volunteer spirit; to accomplish this, the administration increased demands on the nonprofit sector while decreasing revenues); Lester M. Salamon, *The Resilient Sector: The State of Nonprofit America*, in *The State of Nonprofit America*, *supra* note 2, at 12-13 [hereinafter *The Resilient Sector*]. Salamon argues that the Reagan administration attacked government spending in areas where charitable nonprofits were most vulnerable—social and human services, education and training, community development, and non-hospital health. Federal support outside of Medicare and Medicaid declined by twenty-five percent in real dollar terms during the 1980s and returned to 1980 levels only in the late 1990s; then, in 1994, the Contract With America cut even more. Grønbjerg & Salamon, *supra* note 149, at 447; *The Resilient Sector*, *supra*, at 12-13. . Grønbjerg and Salamon here argue that the government funding that fueled the growth of the charitable nonprofit sector in the 1960s and 1970s declined in early 1980s in both absolute and constant terms, at least outside of health care. By the 1990s, the real value of federal support to nonprofit organizations was nineteen percent below its 1980 level in social services and education, forty-two percent below in community development. Grønbjerg & Salamon, *supra* note 149, at 447; Steven Rathgeb Smith, *Social Services*, in *The State of Nonprofit America*, *supra* note 2, at 161 (arguing the Reagan administration's Omnibus Budget Reconciliation Act of 1981 cut spending and shifted spending decisions to the states, which in turn cut funding to nonprofits, particularly in areas of legal aid, family planning, and housing services).

159. Bremner, *supra* note 22, at 206.

160. Hall, *supra* note 118, at 80.

161. *See supra* notes 84, 125-33 and accompanying text.

producers.<sup>162</sup> This meant that the charitable organizations were forced to focus energy on marketing themselves and their services so that they could compete effectively against rival nonprofit organizations as well as an increasing number of for-profit providers.<sup>163</sup>

The charitable nonprofits often found that they had to compete against for-profit firms where the for-profit providers had a clear edge,<sup>164</sup> which in turn increased the ferocity with which the nonprofits turned to the market. Charitable nonprofit organizations often lost out in the supply-side free-for-all set up by the Reagan administration policies, because for-profit firms were able to enter the social services market and siphon off clients that were the least costly to treat, leaving charitable nonprofits to handle the rest despite government reimbursement rates that were insufficient to cover costs.<sup>165</sup> Charitable nonprofit organizations tended to react to this supply-side competition by either folding or becoming more entrepreneurial and commercial.<sup>166</sup>

The Reagan revolution irrevocably changed the law and culture of charity in the United States and in some respects exacerbated our society's confused conception of charity's nature. Charity in this country had always included such tenets as "work or starve," the rejection of charity for the undeserving poor, and an acceptance of the free-market and commercial activity as vehicles for achieving charitable ends. However, the conservative political revolution ushered in by Reagan brought those tenets to the core of our society's conception of charity. At the same time as the Reagan administration was forcing the commercialization of the nonprofit sector, its rhetoric celebrated the older, compassionate, spiritually charged conception. President Reagan offered a vision of society's poor and distressed being tended to by compassionate private actors who would stoop down to offer succor. He declared that "volunteerism is an essential part of our plan to give the government back to the people."<sup>167</sup> His administration would restore the "American Spirit" of voluntary

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162. See Salamon, *The Resilient Sector*, *supra* note 158, at 13.

163. Lester M. Salamon, *Nonprofit Organizations: The Lost Opportunity*, in *The Nonprofit Organization*, *supra* note 13, at 122.

164. *Id.* at 16. For example, \$2 billion in federal daycare subsidies were delivered through a special childcare tax credit, so nonprofit daycare providers were thrown into the private market to secure public money for their operations. They were forced to focus on marketing and on mastering the complex billing and reimbursement systems that had been more common in the for-profit world. This was happening at a time of rapid technological development, when for-profits were better able to acquire technology because they could more readily raise the necessary capital. *Id.*

165. Grønbjerg & Salamon, *supra* note 149, at 457.

166. See Heather Gottry, Note, *Profit or Perish: Non-Profit Social Service Organizations & Social Entrepreneurship*, 6 *Geo. J. on Poverty L. & Pol'y* 249, 254-55 (1999).

167. Bremner, *supra* note 22, at 206.

service and cooperation, of private and community initiative.<sup>168</sup> What he would not do is pay to address the suffering that the well-meaning volunteers failed to stem.<sup>169</sup>

#### D. *Where We Find Ourselves Now*

Charity in the United States has undergone further transformation in the last decade. As we have seen, there is nothing new about insisting that charity be conducted with entrepreneurial zeal, about offering work to the poor instead of alms, or about relying on market-oriented solutions to poverty. Cotton Mather believed in work for the poor and the lash for the unwilling. Benjamin Franklin believed that the proper role of charity was to show promising young men how to become prosperous. State courts in America during the mid- and late 1800s became comfortable with blending charity and for-profit enterprise. Andrew Carnegie insisted on all of the above, and that charity be given only where its efficacy could be demonstrated through scientific study. However, even with all of these historical antecedents, it was not until recent decades that charity in our culture became overwhelmingly and, it seems irrevocably, associated with enterprise and commerce. Let us view the evidence of the turn that charity has taken.

A glance at the nonprofit section of any local bookstore is illuminating. Peons to the deeds of Mother Teresa and Dorothy Day, proponents of the older, Christian love version of charity, have been squeezed out by such titles as *Venture Forth!: The Essential Guide to Starting a Moneymaking Business in Your Nonprofit Organization*,<sup>170</sup> *Selling Social Change (Without Selling Out): Earned Income Strategies for Nonprofits*,<sup>171</sup> *Strategic Tools for Social Entrepreneurs: Enhancing the Performance of Your Enterprising Nonprofit*,<sup>172</sup> *The Social Enterprise Sourcebook*,<sup>173</sup> and finally, the charities' guide to "Comparative Performance Measurement."<sup>174</sup> For managers of those charitable organizations that survived the Reagan era, and whose

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168. *Id.*; see also Gottry, *supra* note 166, at 253-54 (arguing that both President George H.W. Bush's "Points of Light" strategy and President Bill Clinton's backing of AmeriCorps endorsed the Reaganesque notion that social services could be provided by well-meaning volunteers).

169. Hall, *supra* note 118, at 89 (arguing the Reagan administration almost destroyed the nonprofit sector under the pretext of getting the federal government out of nonprofits' way).

170. Rolfe Larson, *Venture Forth!: The Essential Guide to Starting a Moneymaking Business in Your Nonprofit Organization* (2002).

171. Andy Robinson, *Selling Social Change (Without Selling Out): Earned Income Strategies for Nonprofits* (2002).

172. Greg Dees et al., *Strategic Tools for Social Entrepreneurs: Enhancing the Performance of Your Enterprising Nonprofit* (2002).

173. Jerr Boschee, *The Social Enterprise Sourcebook* (2001).

174. Scott P. Bryant et al., *Comparative Performance Measurement* (2001).

organizations have been forced to retool themselves to compete in the free market, these guidebooks are essential reading.

The headlong rush by American charities toward “commercialization” and “marketization” can perhaps be understood best if we divide the movement into two categories that in reality are different aspects of the same phenomenon: social entrepreneurship and venture philanthropy.

### 1. Social Entrepreneurship

Faced with increasing competition for donations and public funds, and under pressure from philanthropic foundations,<sup>175</sup> a growing number of nonprofit charities are adopting the culture and practices of commercial ventures.<sup>176</sup> Twenty years ago the word “entrepreneur” did not exist in the world of charities. Now nonprofits “identify their market niches, to maximize their comparative advantages, to think of their clients as customers, to devise marketing plans, and to engage in strategic planning.”<sup>177</sup> They worry to an ever-greater extent about measurable outcomes and impact, assessing their performance, and demonstrating their cost-effectiveness.<sup>178</sup>

A few concrete examples from the charitable sector will illustrate this sea change. In Durham, North Carolina, a charitable, long-term residential drug rehabilitation center is designed such that the recovering addicts work in profit-making businesses ranging from bricklaying to house painting. These businesses serve the dual purpose of training the addicts for life after drug dependency and generating millions of untaxed dollars per year that go to support the organization’s operating budget. Although members of Durham’s business community occasionally complain about having to compete with a charity,<sup>179</sup> the organization most often is lauded in the local press for showing plucky, entrepreneurial spirit and for running a

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175. See *infra* Part II.D.2.

176. Sharon Oster, *Nonprofit Ventures: The Good Ones Are Profitable*, *Chron. Philanthropy*, Apr. 15, 2002, at 18; see also Salamon, *The Resilient Sector*, *supra* note 158, at 30-38 (arguing charitable nonprofits have undergone a “quiet revolution” and adopted an “enterprise culture”); Young & Salamon, *supra* note 3, at 424 (arguing commercial activity in the nonprofit sector is not new but it appears to have taken a quantum leap over the past decade or more); Jessica Pena & Alexander L.T. Reid, Note, *A Call for Reform of the Operational Test for Unrelated Commercial Activity in Charities*, 76 N.Y.U. L. Rev. 1855, 1856-58 (2001).

177. Young & Salamon, *supra* note 3, at 437.

178. *Id.*; see also Gary Walker & Jean Grossman, *Philanthropy and Outcomes: Dilemmas in the Quest for Accountability*, in *Philanthropy and the Nonprofit Sector in a Changing America*, *supra* note 16, at 450 (claiming the “outcomes movement” represents a more stylish, current jargon for a concept that has existed for a long time).

179. See Ronnie Glassberg, *Nonprofit Competing in Private Sector Criticized*, *Durham Herald Sun*, Jan. 7, 2001, at B1.

large charity that costs taxpayers very little.<sup>180</sup> In New York, the Metropolitan Museum of Art generates tens of millions of dollars through its gift shops, restaurants, parking garages, and other commercial ventures.<sup>181</sup> Most of that money is exempt from taxation, and the proceeds go to support the museum's charitable mission.<sup>182</sup> In Chicago, the Field Museum holds after-hours cocktail socials to generate revenue to support its charitable mission, and in Nashville, Baptist Hospital built and maintains a fifteen million dollar training facility to rent to the Tennessee Titans football team, thus benefiting from both rental profits and football-related marketing opportunities.<sup>183</sup> Lest there should be any doubt that the era of profit-making, entrepreneurial charity has arrived, the Yale School of Management recently teamed with the Goldman Sachs Foundation and the Pew Charitable Trusts to create a Partnership on Nonprofit Ventures that makes cash awards and provides technical assistance to encourage charities to engage in profit-making activities to support their missions.<sup>184</sup>

## 2. Venture Philanthropy

"Venture Philanthropy" is the term used to describe private grant-making foundations' sharp turn in recent years toward the theory and practice of the for-profit world. It is the better-funded doppelganger of "social entrepreneurship."

The popular press celebrates this trend, sometimes under the term "new philanthropy," as an exciting group of social venture capitalists "who use Wall Street solutions to tackle urban poverty."<sup>185</sup> They combine the "desire to help the needy with a geek's approach to problem solving," they "invest" their money rather than donate it, and they are guided by the fundamental question of "[w]here is the highest return on investment?"<sup>186</sup> The press condemns "old philanthropy" as money "doled out by bureaucrats from mahogany-paneled rooms,"

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180. Paul Bonner, *TROSA Breathing New Life Into Old Plant: Milk Factory to House Budding Enterprises for Recovering Addicts*, Durham Herald Sun, Nov. 14, 1996, at C1; Rick Martinez, *Moving Into the Mainstream*, News & Observer (Raleigh), Dec. 24, 2003, at A11; Karine Michael, *Nonprofits in Business to Pay Own Way; Fewer Grants, Growing Need Force Review of Bottom Line*, Durham Herald Sun, Sept. 9, 1998, at B1.

181. Stephanie Strom, *Nonprofit Groups Reach for Profits on the Side*, N.Y. Times, Mar. 17, 2002, at I32.

182. *Id.*

183. John D. Colombo, *Commercial Activity and Charitable Tax Exemption*, 44 Wm. & Mary L. Rev. 487, 489 (2002).

184. *In Brief: Managing*, Chron. Philanthropy, May 2, 2002, at 26; see also Yale Sch. of Mgmt.—The Goldman Sachs Found. P'ship on Nonprofit Ventures, Homepage, at <http://ventures.yale.edu> (last visited Mar. 23, 2005).

185. Michele Orecklin, *How Better to Give*, Chron. Philanthropy, Nov. 5, 2001, at 78.

186. Adam Cohen, *When You Have \$24 Billion . . .*, Time, Nov. 5, 2001, at 80.

and celebrates the new philanthropists as a “new breed of social entrepreneurs coming out of Harvard Business School or failed dot-coms.”<sup>187</sup>

Modeling themselves on venture capital firms, the venture philanthropists seek to “catalyze major public change,” by creating “nonprofit capital markets” in which funders manage “portfolios of social investments” with varying degrees of “social risk and return.”<sup>188</sup> They use a combination of “grant and loan instruments” to implement their investments, try to “maximize the social returns on their investments,” and even use “metrics,” “technology-based tools,” and rating services to carry out their social return assessments.<sup>189</sup> Like venture capitalists, venture philanthropists often demand seats on the boards of the organizations they back, and from the start they create an exit strategy in case their performance expectations are not met.<sup>190</sup> Accelerating this trend, a host of intermediary organizations have sprung up to teach donors how to adopt this model, and, ultimately, “pick social investment winners.”<sup>191</sup>

For our purposes, the main effect of all this venture philanthropy is that the charitable organizations that depend on philanthropic donations are forced to adopt the methods of business and venture capital if they want to continue to receive the foundations’ support. In the 1970s and 1980s, it was the government that was pushing charities toward the market. Today, private foundations are doing the same.

Commentators on American charity range from enthusiastic to apprehensive<sup>192</sup> about the explosion of venture philanthropy and

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187. Adam Piore, *Charities That Hate to Just “Give,”* Newsweek, Feb. 4, 2002, at 37.

188. *Id.*

189. Young & Salamon, *supra* note 3, at 438; see also Todd Coher, *Global Marketplace: Rockefeller Foundation Launches Acumen Fund*, The Non-Profit Times, Aug. 15, 2001, at 15; Dana Flavelle, *Charities Run Like For-Profit Businesses*, Toronto Star, Apr. 22, 2002, at C1 (discussing a billionaire venture capitalist who developed a method for measuring “social return on investment” or SROI); Brad Wolverton, “*Business Week*”: *A New Era of Philanthropy*, Chron. Philanthropy, Dec. 12, 2002, at 31. See generally Acumen Fund, Homepage, at <http://www.acumenfund.org> (last visited Mar. 23, 2005).

190. Piore, *supra* note 187, at 37.

191. Scott Harris, *Giving When It Hurts*, The Industry Standard.Com, July 30, 2001, at <http://www.theindustrystandard.com> (helping foundations “convert from the bureaucratic paradigm” to the methods of “strategic philanthropists”); see Beth Healy, *Strategy for Giving Start-Up a Vehicle for Budding Philanthropists*, Boston Globe, Nov. 23, 2001, at B14.

192. Criticisms are many, but perhaps two varieties are most common. First are the ethical and legal criticisms. Commentators point to numerous instances where entrepreneurial charitable organizations either enrich their principle staff people or divert business toward for-profit affiliates. See, e.g., Burton A. Weisbrod, *The Nonprofit Mission and Its Financing: Growing Links Between Nonprofits and the Rest of the Economy*, in *To Profit or Not To Profit: The Commercial Transformation Of The Nonprofit Sector 1* (Burton A. Weisbrod ed., 1998) (discussing a widely criticized endorsement deal between the nonprofit American Medical Association and the

social entrepreneurship in the United States, but practically all agree that the shift has been developing for a long time, has deep roots in American culture, and that it is here to stay.<sup>193</sup>

### E. Summary

Man's tendency to act charitably toward his fellow man is a "hard wired" aspect of humanity, and charity as a fundamental social and cultural norm can be traced to antiquity. The Anglo-American legal and cultural tradition of charity sprang out of Judeo-Christian notions of love and selflessness. The pre-Reformation version of charity required God's servants to aid the suffering without inquiry into whether they were deserving of kindness.<sup>194</sup>

As early as the thirteenth century, there were rumblings that charity would be caught up in the drastic economic and social changes unfolding in England. In the thirteenth and fourteenth centuries there were halting, awkward legislative efforts to contain the wandering and

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Sunbeam Corporation); Gary E. Knell, *Sesame Workshop Misrepresented*, Chron. Philanthropy, Nov. 15, 2001, at 39 (discussing and defending against accusation that nonprofits are making untoward, tax-exempt profits); Editorial, *Marie C. Malaro, Former Director . . .*, Wash. Post, Feb. 10, 2002, at B2 (reporting controversy when a corporate donor to the Smithsonian Institute gave forceful input on the content of funded exhibits); Jeffrey R. Young, *College Board Shuts Down For-Profit Entity*, Chron. Higher Educ., Jan. 24, 2003, at A34 (claiming it is ethically suspect for a nonprofit testing organization to sell on-line services related to its tests). Second, critics point to erosion of society's trust in charities as they become more commercially market-oriented. See Clotfelter & Ehrlich, *The World We Must Build, in Philanthropy and the Nonprofit Sector in a Changing America*, *supra* note 16, at 500. The argument is that the charitable nonprofit sector has provided American society with a philosophical structure and a language with which to express moral values and a noncompetitive arena in which to build a stronger civil society. Robert L. Payton, *A Tradition in Jeopardy, in Philanthropy and the Nonprofit Sector in a Changing America*, *supra* note 16, at 485. Now, however, the nonprofit sector's claims to exist for the public good—the very grounds on which society justifies exempting the sector from taxation—are no longer taken on faith. The growing confluence of the market and charity is feeding the idea that the charitable sector is not the only, nor necessarily the best, guardian of public worth. Evelyn Brody, *Accountability and Public Trust, in The State of Nonprofit America*, *supra* note 2, at 472. There is one other broad category of criticism of the blending of sectors: a practical critique. It holds that the need to generate income and closely justify all expenditures leaves charities little incentive to focus services on the poor because serving them costs the most. The pressure to be entrepreneurial pushes managers of charitable organizations away from assuming responsibility for costly services. In such a system, who is going to take care of the crack addicts and ex-offenders? See William Diaz, *For Whom and for What? The Contributions of the Nonprofit Sector, in The State of Nonprofit America*, *supra* note 2, at 519; see also Young & Salamon, *Commercialization, Social Ventures, and For-Profit Competition, in The State of Nonprofit America*, *supra* note 3, at 442.

193. See Glen Gose, *A Revolution Was Ventured but What Did it Gain?*, Chron. Philanthropy, Aug. 21, 2003, at 6 (reporting that venture philanthropy's influence has continued despite the economic downturn).

194. See Gladstone, *supra* note 7, at 30.



begging that was arising as a result of enclosures and early mercantilism.<sup>195</sup>

The reign of Henry VIII marked a stark change in the law and culture of Anglo-American charity. Henry's Reformation, combined with the enclosure movement and the rise of mercantile capitalism, gave rise to a new conception of charity that was more secular, focused on addressing poverty and pauperism ("social engineering") rather than divine grace for the donor, and included at its core the notion that enterprise and work were the most effective tools for addressing poverty.

Through numerous legislative acts in the sixteenth century, culminating in the Poor Laws and the Statute of Charitable Uses of 1601, the state acknowledged that it, along with private donors, had a role to play in addressing poverty. Its preferred method for carrying out that role was to force work upon those in need, and to severely punish the sturdy poor who shirked.

Early American charity followed a similar path, and was premised on the belief of man's individual responsibility before God, on the discouragement of "promiscuous alms," and on the identification of work with moral rectitude and divine approval.<sup>196</sup> After the Civil War, with the rise of friendly visiting and scientific philanthropy, the attitude of poverty as moral vice persisted, while at the same time the language and methods of the free market began to infiltrate American charity. After the turn of the century, American culture and American law began to accept the view that commercial activity could and indeed should be closely associated with charity.

The Reagan revolution pushed charities toward the market by cutting back on funds for their operations and by implementing policies that compelled them to compete—with one another and with for-profit companies—for scarce dollars. At the same time, the Reagan administration and subsequent administrations celebrated a rhetoric of compassionate service to the needy and volunteerism. During the 1990s, the trend toward commercialization of charity strengthened as technology-boom millionaires entered the charitable realm and insisted on the adoption of business methods, and as private foundations increasingly adopted the rhetoric and practices of venture philanthropy. By the end of the 1990s, it was becoming difficult to distinguish between business and charity.

It is important for our purposes to emphasize that while the cultural and legal conception of charity has shifted away from alms to the poor and toward social engineering since the reign of Henry VIII, the older brand of vulgar charity has persisted.<sup>197</sup>

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195. See Leonard, *supra* note 35, at 9; *supra* notes 50-51 and accompanying text.

196. See *supra* Part I.B.5.

197. See *supra* Part I.B.1.; see also Gray, *supra* note 28, at vii.

## II. CHARITY LAW IN THE UNITED STATES: THE DEEP ROOTS OF CONFUSION

We have completed a sweep through the history of Anglo-American charity. We have seen how our culture has maintained through the centuries a split definition of charity, meaning both aid to the poor based on love and compassion and social engineering, often premised on the assumption that providing work was the primary, if not the only, valid response to poverty. We will now narrow our focus to the American law of charity and discover that our society's unresolved definition of charity has led to a legal regime that most commentators consider incoherent<sup>198</sup> and confusing.<sup>199</sup>

### A. *Confusion in Early Case Law Definitions of Charity*

Today, most charity law in the United States emanates from the federal government, particularly in the Internal Revenue Code and the accompanying regulations. However, federal tax laws did not begin to affect American charity in any significant way until after the institution of federal income tax in 1913.<sup>200</sup> The American legal system's confusion about charity was evident significantly earlier.

In the late 1800s and early 1900s, state courts across the country expressed disagreement over the proper legal definition of charity.<sup>201</sup> Some, hewing to the vulgar conception, held that charity was "whatever is given for the love of God, or for the love of your neighbor, in the Catholic and universal sense—given from these motives, and to those ends, free from the stain or taint of every consideration that is personal, private, or selfish."<sup>202</sup> Others insisted that a donor's motivation for giving was irrelevant, and that the proper legal definition of charity, in the tradition of the Statute of Charitable Uses and the English common law, depended on whether the gift in question was for the benefit of the general public and eased burdens on government.<sup>203</sup>

Echoing the problems that contemporary charities face, state courts in that day disagreed over what should happen when purported charities produced earned income. Numerous cases assessed the

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198. Fishman, *supra* note 4, at 618; Gary N. Scrivner, *100 Years of Tax Policy Changes Affecting Charitable Organizations*, in *The Nonprofit Organization: Essential Readings*, *supra* note 13, at 126.

199. See Hopkins, *supra* note 2, at 90 (arguing that Congress itself was confused over what it meant by "charitable" when it passed charitable tax legislation).

200. See *infra* Part II.B for a discussion of early federal tax laws.

201. Most of these cases arose in the trust law context or in cases in which organizations were seeking property tax abatements based on their purportedly charitable status.

202. See *supra* note 2; see also *Hamburger v. Cornell Univ.*, 199 N.Y.S. 369, 372 (App. Div. 1923).

203. See, e.g., *Fire Ins. Patrol v. Boyd*, 15 A. 553, 555-56 (Pa. 1888).

charitable status of poorhouses, workhouses, and convalescent homes that required residents to engage in profit-generating labor to defray the organizations' operating expenses. Some state courts had no trouble finding such organizations charitable<sup>204</sup> even where the commercial activities were substantial and funds went to the pay the salaries of staff members.<sup>205</sup> Other courts examining similar organizations assigned charitable status only if they found that the organizations did not use the commercially generated fees to pay salaries for the organization's employees,<sup>206</sup> or that the fee-generating activity was merely "incidental to the organization's charitable mission."<sup>207</sup>

Similarly, during the late nineteenth and early twentieth centuries, courts around the country grappled with whether organizations like schools and hospitals that accepted or demanded fees from the beneficiaries of their services could be considered charitable. Some courts found that schools could charge tuition and remain charitable so long as the fees did not amount to any more than "self-support" for the institution.<sup>208</sup> Others required more stringent proof of charitable purpose from fee-generating organizations, for example, that the organizations consistently lost money in spite of collecting fees.<sup>209</sup> Still others rejected charitable status for fee-generating institutions, often relying on vague rationales such as "the fees charged [were] very considerable,"<sup>210</sup> or conclusory statements that the organization in question had "a commercial aspect."<sup>211</sup>

In short, cases from the late nineteenth and early twentieth centuries that wrestled with the legal definition of charity reveal ambiguity and uncertainty. Results seem to be determined by the predilections of the examining judges and whether or not they believed that the organizations in question looked and felt charitable given their particular conceptions of the meaning and role of charity.

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204. See, e.g., *House of Refuge v. Smith*, 21 A. 353, 353 (Pa. 1891).

205. See *Paterson Rescue Mission v. High*, 44 A. 974, 976 (N.J. 1899).

206. See, e.g., *House of the Good Shepherd of Omaha v. Bd. of Equalization (In re House of the Good Shepherd of Omaha)*, 203 N.W. 632, 634 (Neb. 1925).

207. *Contributors to Pa. Hosp. v. Delaware County*, 32 A. 456, 457 (Pa. 1895); see also *Franklin Square House v. City of Boston*, 74 N.E. 675 (Mass. 1905).

208. *State ex rel. Cunningham v. Bd. of Assessors of Parish of Orleans*, 26 So. 872, 875 (La. 1898); *Trs. of Acad. of Protestant Episcopal Church v. Taylor*, 25 A. 55, 57 (Pa. 1892); see also *Santa Rosa Infirmary v. San Antonio*, 259 S.W. 926, 936 (Tex. 1924).

209. *Trs. of Ky. Female Orphan Sch. v. City of Louisville*, 36 S.W. 921, 924 (Ky. 1896) (relying on the fact that charges were "incidental"); *Bd. of Comm'rs of Tulsa County v. Sisters of the Sorrowful Mother*, 283 P. 984, 985 (Okla. 1930).

210. *Bancroft Sch. v. State Bd. of Taxes and Assessment*, 60 A. 390, 391 (N.J. 1932); see also *Boston Symphony Orchestra v. Bd. of Assessors*, 1 N.E.2d 6, 10 (Mass. 1936) (rejecting charitable status for symphony partly on grounds that it charged too much for tickets); *Dwight Sch. of Englewood v. State Bd. of Tax Appeals*, 177 A. 875, 877 (N.J. 1935) (finding teachers' salaries too high and school profits too great).

211. *Bancroft*, 160 A. at 391.

Some cases showed a preference for charity as compassion, holding to the view that an act must spring from Christian love and be directed at the relief of suffering if it were to enjoy the legal advantages of charitable status. Others implicitly or explicitly approved of charity as social engineering in which charitable recipients could be compelled to work for their keep and where commerce was a legitimate tool for accomplishing socially desirable ends.

### B. *Confusion in the Early Federal Tax Law Definition of Charity*

In the late 1800s, as state courts around the country were wrestling awkwardly and inconsistently with the legal conception of charity, the center of gravity of charity law began to shift toward the federal government. The transition began with the federal government's efforts to impose the country's first income taxes and, along with the income tax laws, the country's first charitable tax exemptions. If the transition from state to federal law presented an opportunity to clarify our country's uncertain legal understanding of charity, that opportunity was missed.

The Tariff Act of 1894, the first major piece of federal legislation that attempted to specify what types of organizations would be subject to federal taxation, exempted nonprofit charitable, religious, and educational organizations and provided for a corporate income tax deduction for donations to charitable entities.<sup>212</sup> Although the 1894 Act was overturned on constitutional grounds, similar legislation was passed in 1913 after the implementation of the 16th Amendment.<sup>213</sup> Setting a pattern of uncertainty, the legislative committee reports that accompanied the 1913 Act revealed little about Congress's motivations for exempting charitable organizations from taxation, or about what it considered to be charitable.<sup>214</sup>

Bruce Hopkins offers two related arguments to support an assertion that Congress, from the time it first passed the charitable tax exemption until quite recently, intended to use the word "charity" in its vulgar sense. His first argument is one of common-sense statutory construction. The early tax codes' description of tax-exempt organizations always used the terms "charitable, religious, or educational." If Congress had intended the word "charitable" to be understood in its broad, English common law, social engineering sense, it would not have made sense to enumerate the other types of organizations (religious or educational), because the common law definition was more than broad enough to subsume them. It thus

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212. Tariff Act of 1894, ch. 349, 28 Stat. 509, 556; see Scrivner, *supra* note 198, at 126.

213. Scrivner, *supra* note 198, at 127.

214. *Id.*

stands to reason that Congress was using the term charity in its vulgar, narrower sense of aiding the poor.<sup>215</sup>

Hopkins's statutory construction argument is buttressed by subsequent legislative history. Through the early and mid-twentieth century, each new revision of the Revenue Act contained a provision that included the charitable tax exemption—the provisions that later became known by the Code section that contained them, 501(c)(3). With each revision, the regulations that accompanied the acts consistently defined charity as “relief of the poor.”<sup>216</sup> For example, during the fifteen years that the Revenue Act of 1939 was in effect, the IRS issued three separate sets of regulations, and each of them defined the term charitable in its vulgar sense.<sup>217</sup> When Congress passed the Internal Revenue Code of 1954, (which was when the charitable tax exemption provisions first were gathered in section 501), an accompanying report of the House Committee on Ways and Means commented that “[n]o change in substance has been made.”<sup>218</sup> Thus, at the adoption of section 501 of the Code in 1954, the popular and ordinary, or vulgar, meaning of the term charitable governed the definition of that word for federal tax purposes.<sup>219</sup>

However, by the time the IRS regulations to the 1954 Act appeared in 1959, the IRS, without the approval of Congress, had vastly expanded the federal tax definition of charitable. Those regulations defined it

in its generally accepted legal sense, [m]eaning [r]elief of poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency.<sup>220</sup>

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215. Hopkins, *supra* note 2, at 90. The obvious practical result of this narrower definition would be that socially beneficial organizations would not qualify for tax exemption unless they benefit the poor and needy, are religious, or educational. Indeed, early administrative decisions by the IRS indicate that this was their view. *See, e.g.*, I.T. 1800, 2-2 C.B. 152, 153 (1923).

216. *See, e.g.*, Treas. Reg. § 19.101(6)-1 (1938); Treas. Reg. 94, art. 101(6)-1 (1936); Treas. Reg. 69, art. 517 (1926); Treas. Reg. 65, art. 517 (1924); *see also*, Hopkins, *supra* note 2, at 91.

217. Hopkins, *supra* note 2, at 91.

218. Internal Revenue Code, ch. 736, 68 Stat. 163, 163 (current version at 26 U.S.C. § 501 (2000)); Hopkins, *supra* note 2, at 91 (citing H.R. Rep. No. 83-1337, 83d Cong., 2d Sess., at 165 (1954), 1954 U.S.C.C.A.N. 4017).

219. Hopkins, *supra* note 2, at 91.

220. Treas. Reg. § 1.501(c)(3)-1(d)(2) (as amended in 1990).

Suddenly, with the issuance of this language, it appeared that aiding the poor was only one meaning of charitable. For federal tax purposes, the English common law notions of charity—including ideas about social engineering through finding work for the needy—counted.<sup>221</sup>

The 1959 IRS regulations adopted a definition of charity that apparently was at odds with what Congress intended, but because Congress never took action to reign in the expanded legal definition, it became accepted doctrine with the passage of time and is the legal definition of charity that we live with today.<sup>222</sup> As to why Congress remained silent, we simply do not know.

What we do know is that Congress's inaction left us with a legal definition broad enough (one might say vague enough)<sup>223</sup> to encompass all of the diverse meanings of *charity* that had come down through the Anglo-American cultural and legal tradition. It is this vague definition that has led in our day to confused and contradictory court cases and legal doctrines.<sup>224</sup> In recent times, as the trends toward social entrepreneurship and venture philanthropy have accelerated,<sup>225</sup> and as the bounds between for-profit and nonprofit enterprises have blurred, our vague, ill-discussed, ill-defined legal definition of charity has been too amorphous to lend structure to the difficult task of sorting out what is and is not charitable in the eyes of the law. The result has been the piecemeal, ad hoc development of the unworkable, often inconsistent legal doctrines discussed below.

### C. *Confusion in Contemporary Legal Doctrines Governing American Charity*

Lacking a specific, workable definition of charity, federal tax law has developed a series of tests and doctrines to help it determine which activities and organizations should qualify for charitable tax exemption and which should not. These tests include the operational test, the commerciality doctrine, UBIT, and the commensurate-in-scope doctrine. When today's entrepreneurial charities find themselves caught in the double bind described in the introduction to this Article, their legal problems often stem from some combination of these. Although it is possible to devise a conceptual framework that separates and to a large extent harmonizes the doctrines, in practice the IRS and examining courts apply them interchangeably

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221. *Id.*

222. *Id.*; Hopkins, *supra* note 2, at 92.

223. See Hopkins, *supra* note 2, at 92 (arguing that today's legal definition of charity is unmanageably broad); see also Tommy F. Thompson, *The Unadministrability of the Federal Charitable Tax Exemption: Causes, Effects and Remedies*, 5 Va. Tax Rev. 1, 13-14 (1985).

224. See *supra* Parts II.A-B.

225. See *supra* Part I.D.

and inconsistently, such that contemporary entrepreneurial charities—even those with sophisticated legal counsel—cannot confidently navigate them. The discussion below briefly summarizes the doctrines and explains why together they constitute a murky legal swamp.

### 1. The Operational Test

The first significant legal step for a charitable organization wishing to obtain exemption from federal income taxation is to pass the IRS's operational test.<sup>226</sup> It can be an exacting test, and it is the first place that many new organizations, particularly those with an entrepreneurial bent, become mired in the confusing American law of charity.

The operational test requires that an “organization’s resources must be devoted to purposes that qualify as exclusively charitable within the meaning of section 501(c)(3) of the [IRS] Code and the applicable regulations.”<sup>227</sup> The word “exclusively” in the statute is interpreted by IRS regulations to mean “primarily” or “substantially,”<sup>228</sup> so that an aspiring charity will fail the operational test if more than an insubstantial part of its activities are not in furtherance of its charitable purpose.<sup>229</sup> There are certain common non-charitable activities that cause aspiring or existing charities to fail the operational test; for example, because they pay profits to insiders, devote their services to a too-narrow class of beneficiaries, or engage in inappropriate amounts of lobbying or in political campaigning.<sup>230</sup>

More relevant for our purposes, the operational test also ensnares organizations that devote too much of their efforts to commercial rather than charitable activity. Given the burgeoning growth of commercial enterprise among charitable organizations,<sup>231</sup> it should not be surprising that the operational test has become a problem for many organizations.<sup>232</sup>

For all the vagaries of the operational test, discussed below, it clearly does permit charities to engage in some degree of commercial activity. The vexing question is, “How much?” Section 501(c)(3) of the Code neither states nor implies anything about the permissible

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226. See Treas. Reg. § 1.501(c)(3)-1(a)-(b). Aspiring charities must also pass the IRS's “organizational test,” which is, in essence, a “magic words” test. The applying organization merely must show that certain clauses—promising to eschew lobbying and political activity and all private inurement, for example—have been included in the organization's founding documents. *Id.*

227. Hopkins, *supra* note 2, at 66 (citing Rev. Rul. 72-369, 1972-2 C.B. 245).

228. Treas. Reg. § 1.501(c)(3)-1(c)(1); see Colombo, *supra* note 183, at 495-96.

229. Treas. Reg. § 1.501(c)(3)-1(c)(1); Hopkins, *supra* note 2, at 66.

230. See Treas. Reg. § 1.501(c)(3)-1(c)(2)-(3).

231. See *supra* note 176 and accompanying text.

232. Pena & Reid, *supra* note 176, at 1861 (arguing the operational test is being used by the IRS “to challenge troublesome amounts of commercial activity in charities”).

bounds of charities' commercial activities. The related Treasury Regulations, however, reveal the law's supposed tolerance for profit making.

Treasury Regulation section 1.501(c)(3)-1(e), concerns "[o]rganizations carrying on trade or business," which for our purposes can be taken as synonymous with commercial activity. It begins with unambiguous language stating that:

An organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the exempt organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business . . . .<sup>233</sup>

Stated otherwise, a charity may operate a trade or business that is in furtherance of its charitable purpose to whatever extent it pleases without violating the operational test. If, however, the charity engages in trade or business that is not in furtherance of its exempt purpose and if that trade or business becomes the primary purpose of the organization, it will lose its charitable, tax-exempt status.<sup>234</sup>

It is important to emphasize that by the terms of the operational test regulations, the analysis of a charity's commercial activity should focus on the purpose of that activity, not its nature.<sup>235</sup> Thus, it should not matter that a charity serving the blind is fabricating and selling light bulbs to the public at a profit (a description of the commercial nature of the activity) if that activity is intended to provide training and employment to blind people (a description of the activity's purpose).<sup>236</sup>

In sum, if one believes the wording of the regulations, the application of the operational test to charities engaged in commercial activities should be straightforward: First, identify which commercial activities are in furtherance of the organization's charitable purposes; second, make sure that those commercial activities not in furtherance of the charitable purposes are not the organization's primary purpose.<sup>237</sup>

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233. Treas. Reg. § 1.501(c)(3)-1(e).

234. *Id.*; see Colombo, *supra* note 183, at 497; Pena & Reid, *supra* note 176, at 1864. The confusion of navigating the charity doctrines is compounded by the fact that these doctrines use inconsistent language. The operational test asks if a given activity is "in furtherance of" the organization's charitable purpose. Treas. Reg. § 1.501(c)(3)-1(e). On the other hand, determining whether UBIT applies to commercial charities turns on whether the activity is "related to" the organization's charitable purpose. Conventional thinking is that the differently named concepts mean essentially the same thing. See Hopkins, *supra* note 2, at 646.

235. Treas. Reg. § 1.501(c)(3)-1(e)(1).

236. *Id.*; see Bradley Meyers, *Revisiting the Commerciality Doctrine*, 10 J. Affordable Housing & Community Dev. L. 134, 136 (2001).

237. Treas. Reg. § 1.501(c)(3)-1(e)(1); see Pena & Reid, *supra* note 176, at 1865.



But what appears simple in the regulation has become muddled in the execution. For unknown reasons (though I will speculate in Part II.C.5, below) the IRS eschews the obvious two-part inquiry, and instead employs a “subjective ‘facts-and-circumstances’ standard” to determine whether a charity flunks the operational test due to commercial activity.<sup>238</sup> Under this broad facts-and-circumstances inquiry, the analysis deteriorates into an unprincipled, unpredictable test that amounts to an examination of whether the organization “smell[s] like” a charity to whomever is inquiring.<sup>239</sup>

The IRS and courts applying the operational test to commercial activity by charities also routinely ignore the distinction between examining the nature of the activity and the purpose of the activity. One of the seminal court decisions in this area, *B.S.W. Group, Inc. v. Commissioner*, explained the law correctly, saying that it is the “purpose towards which an organization’s activities are directed, and not the nature of the activities themselves, [that are] ultimately dispositive of the organization’s right to be classified as a section 501(c)(3) organization.”<sup>240</sup> However, many other courts<sup>241</sup> and the IRS itself<sup>242</sup> routinely confuse the analysis and focus on the nature of the activities (whether they look and feel inappropriately commercial), ignoring the question of whether the activities are related to the organizations’ charitable purposes. More often than not, examining authorities launch into a facts-and-circumstances test whenever an organization engages in commercial activity of any kind.<sup>243</sup> When this happens, the determination of charitable status under the operational test becomes as untethered and ad hoc as the muddled state court decisions that determined the legal bounds of charity at the end of the nineteenth century.<sup>244</sup>

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238. Pena & Reid, *supra* note 176, at 1865.

239. *Id.*

240. *B.S.W. Group, Inc. v. Comm’r*, 70 T.C. 352, 356-57 (1978).

241. *See, e.g.*, *Nonprofits’ Ins. Alliance of Cal. v. United States*, 32 Fed. Cl. 277, 293 (1994) (upholding denial of tax exemption to organization that provided insurance to nonprofits); *Bethel Conservative Mennonite Church v. Comm’r*, 80 T.C. 352, 361 (1983) (upholding denial of exemption where church offered medical plan to congregation members only) *rev’d*, 746 F.2d 388, 391-92 (7th Cir. 1984) (ruling the Tax Court should have inquired whether medical plan furthered the church’s exempt purposes); *Copyright Clearance Ctr. v. Comm’r*, 79 T.C. 793, 803 (1982) (finding nonexempt purpose but failing to analyze organization’s charitable purposes); *see also* Pena & Reid, *supra* note 176, at 1870.

242. *See* Pena & Reid, *supra* note 176, at 1883. These student commentators argue that while the IRS formally asserts that it adheres to the judicially created facts-and-circumstances test to determine whether or not a charity is engaging in substantial amounts of unrelated commerce in violation of the operational test, its administrative rulings have rarely involved this analysis. In practice, the IRS generally makes determinations in a conclusory manner, offering minimal rationale and often simply bypassing the inquiry all together. *Id.* at 1884.

243. *See id.* at 1871.

244. *See supra* Part II.A.

Why is this area of law beset by such doctrinal confusion? One answer is that judges and administrative authorities have difficulty pinpointing what qualifies as “in furtherance of” a legitimate charitable purpose because there is no precise, widely accepted view of what the law means by charity. Had Congress stuck to the original definition contained in the earliest federal charitable exemption provisions, relief of the poor, it would have been comparatively simple for judges to determine which commercial activities did and did not qualify as “in furtherance of.” Instead, we have inherited the definition of charity laid out in Treasury Regulation section 1.501(c)(3)-1(d)(2), which includes within its ambit not only religion and education but such hazy concepts as the “lessening of the burdens of Government,” and the “promotion of social welfare.” This makes it extremely difficult for judges and regulators and for charities themselves to make meaningful, legally recognizable distinctions between commercial activity that is and is not in furtherance of a charitable purpose.<sup>245</sup>

There is another more speculative, but perhaps more compelling, explanation of why judges and administrators wield the wet noodle of the facts-and-circumstances test when called upon to distinguish between charitable and non-charitable organizations under the operational test. That explanation, which draws upon the historical tradition of Anglo-American charity, will be laid out in more detail in Part II.C.5 below.

## 2. The Commerciality Doctrine

The commerciality doctrine is so vague and malleable that it strains the bounds of legal rhetoric to call it a doctrine.<sup>246</sup> However, this particular doctrine (or non-doctrine) wreaks havoc in the world of entrepreneurial charities, and since it is difficult to critique a doctrine that completely lacks substance, we must attempt to sketch its contours and explain its application.

By way of definition, Hopkins offers the following gossamer explanation of commerciality:

A tax-exempt organization is engaged in a nonexempt activity when that activity is engaged in a manner that is considered *commercial*.  
An act is a commercial one if it has a direct counterpart in, or is

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245. See Thompson, *supra* note 223, at 12-13.

246. This footnote is intended for readers familiar with the Harry Potter series of novels. I explain the commerciality doctrine to my law students by likening it to the bludger in a game of quiddich. The bludger is a small, hard ball that flies through the air knocking players off their broomsticks when they are concentrating on other aspects of the game. Like the commerciality doctrine, the bludger produces anxiety in players because it is absolutely unpredictable: No one knows when it will strike and what kind of damage it will cause. See J.K. Rowling, *Harry Potter and the Sorcerer's Stone* (1999).

conducted in the same manner as is the case in the realm of for-profit organizations.<sup>247</sup>

If that description of the doctrine's ambit sounds familiar, it is because we just completed a discussion of the operational test, which, in the context of charitable organizations that engage in commercial activities, can cover much the same ground. The two doctrines can be conceptually harmonized if one considers the commerciality doctrine as a subset of the operational test. That is, when a court or the IRS applies the operational test to determine whether a charity engages in more than an "insubstantial amount" of non-charitable activity, and if the non-charitable activity in question is commercial activity unrelated to the organization's mission (as opposed to, say, lobbying), then the examining authority will apply the commerciality doctrine.

Life for entrepreneurial charities would be easier if courts and the IRS consistently applied the operational test and the commerciality doctrine in this way, but alas they do not. In practice, courts and the IRS sometimes assess commercial activity using the rubric of the operational test without ever mentioning the commerciality doctrine; others do the opposite, and a few actually mention both and attempt to describe the connection between the two.<sup>248</sup>

Forced to grapple with such a slippery doctrine, the first instinct of a lawyer representing an entrepreneurial charity would be to examine the words of the statute from whence it came. In this case, however, the examination would prove fruitless, as the doctrine grew out of "loose language in court opinions, which in turn seem to have reflected judges' personal views as to what the law ought to be (rather than what it is)."<sup>249</sup>

The first whispers of commerciality appeared in the 1924 case *Trinidad v. Sagrada Orden de Predicadores de la Provincia del Santisimo Rosario de Filipinas*,<sup>250</sup> in which the Supreme Court grappled with whether a religious order could be considered charitable and thus exempt from federal income taxation where the order produced revenue through real estate and stock investments as well as through the limited sale of commercial products such as chocolate and wine.<sup>251</sup> The IRS, arguing before the development of today's operational test, contended that the religious order was maintained for "business and commercial purposes," and therefore should have its charitable tax exemption revoked.<sup>252</sup> The Court rejected this argument, relying vaguely on the rationale that the organization was not engaged in "competition" with for-profit firms,

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247. Hopkins, *supra* note 2, at 629-30.

248. See Colombo, *supra* note 183, at 497.

249. Hopkins, *supra* note 2, at 633; see also Meyers, *supra* note 236, at 134.

250. 263 U.S. 578 (1924).

251. *Id.* at 580-81.

252. *Id.* at 581.

and that the profits that were generated by the various activities were a “negligible factor” in its overall funding.<sup>253</sup> From these seemingly innocuous statements, the commerciality doctrine was born.<sup>254</sup>

The commerciality emanations from the U.S. Supreme Court opinion in *Trinidad* gave rise to a brief golden era in the development of commercial enterprises by charities. The presiding legal doctrine became known as the destination-of-income test, which held, in essence, that so long as an organization’s commercial profits were destined to fund its charitable goals, its status as a tax-exempt charity was safe.<sup>255</sup> Commercial “feeder organizations” sprang up that generated commercial profits and then fed these profits directly to their parent charities. Until they were reigned in, charitable organizations felt free to run businesses that were completely unrelated to their charitable missions, and whose profits supported their charitable work. The most notorious of these was the Mueller Macaroni Company, which held a significant share of the United States macaroni market, but which generated all of its profits tax-free because it was owned by and fed its earnings to New York University School of Law.<sup>256</sup>

A little more than twenty years after *Trinidad*, the Court applied the commerciality doctrine in a way that called into question the viability of the destination-of-income test. In *Better Business Bureau v. United States*,<sup>257</sup> the Court was asked to determine whether the Better Business Bureau qualified for exemption as an educational organization. The Court stated that the “exclusivity” requirement of section 501(c)(3) of the Code “plainly means that the presence of a single noneducational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes.”<sup>258</sup> It concluded that although most of the Better Business Bureau’s activities were indeed educational—teaching merchants about ethical business practices, for example—its goal of promoting a profitable local business community was noneducational, that the organization therefore could be said to have a “commercial hue,” and that its “activities [were] largely animated by this commercial purpose.”<sup>259</sup>

In the years before and after the *Better Business Bureau* decision, there was confusion over how much, if any, commercial activity charities could permissibly engage in. Some rulings applied the

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253. *Id.* at 582.

254. *See* Hopkins, *supra* note 2, at 634; Colombo, *supra* note 183, at 497-98.

255. *See* Meyers, *supra* note 236, at 136.

256. *See* C.F. Mueller Co. v. Comm’r, 479 F.2d 678 (3d Cir. 1973) (upholding denial of tax exemption for macaroni profits).

257. 326 U.S. 279 (1945).

258. *Id.* at 283.

259. *Id.* at 283-84; *see also* Hopkins, *supra* note 2, at 635; Colombo, *supra* note 183, at 499.

destination-of-income test<sup>260</sup> while others grappled awkwardly with *Better Business Bureau's* "commercial hue" concept.<sup>261</sup> Attempts to clarify the field came in two forms. First, in 1950 Congress passed UBIT, which eliminated the destination-of-income test and began taxing commercial activity that was unrelated to exempt organizations' charitable purposes. Second, federal courts handed down a series of decisions that put teeth, if not predictability, into the commerciality doctrine. We will examine the further development of the commerciality doctrine directly below, and then turn in Part II.C.3 to a description of UBIT and its effects.

In the 1960s, the IRS and courts began regularly applying the commerciality doctrine, striking fear into the hearts of fee-generating charities.<sup>262</sup> The vagaries of the doctrine were revealed in a line of cases focusing on nonprofit religious publishing organizations. The first, *Scripture Press Foundation v. United States*,<sup>263</sup> involved an organization that published and sold religious texts with the aim of improving the quality of Protestant Sunday school instruction.<sup>264</sup> The organization became highly successful and accumulated more than \$1.6 million in profits, an amount the IRS found unacceptable and the court agreed was "very substantial."<sup>265</sup> The court concluded that the large profits furnished "some evidence indicative of a commercial character."<sup>266</sup> The court also found it significant that Scripture conducted its business in a manner similar to for-profit religious publishers, and engaged only in an "incidental" amount of activity that was purely religious.<sup>267</sup> The court never discussed whether the profit-generating activity at issue was related or unrelated to the organization's charitable purpose, as the operational test would have dictated.<sup>268</sup> The court simply found, based on all the circumstances, that the organization was too commercial, and revoked its federal tax exemption.

There followed a series of commerciality cases focusing mainly on nonprofit publishers.<sup>269</sup> By the time that string of cases ran its course,

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260. See, e.g., *Roche's Beach, Inc. v. Comm'r*, 96 F.2d 776, 779 (2d Cir. 1938) (finding a corporate owner of beach property exempt where profits support a charitable foundation).

261. See *infra* notes 270, 275-82 and accompanying text.

262. See Colombo, *supra* note 183, at 501.

263. 285 F.2d 800 (Ct. Cl. 1961).

264. *Id.* at 803.

265. *Id.* at 804.

266. *Id.* at 803.

267. *Id.* at 805-06 & n. 11.

268. See *supra* Part II.C.1.

269. See, e.g., *Elisian Guild, Inc. v. United States*, 292 F. Supp. 219, 221 (D. Mass. 1968) (a publisher lost exemption where it conducted itself like a for-profit publisher and "clearly engaged primarily in a business activity") *rev'd*, 412 F.2d 121 (1st Cir. 1969) (on grounds that the organization was not excessively commercial where it did not produce operating profits); *Fides Publishers Ass'n v. United States*, 263 F. Supp.

it seemed clear that courts and the IRS were going to ignore the question that was demanded by IRS regulations, namely whether a given organization's profits were in furtherance of its charitable mission, and instead would decide commerciality cases based on a loose and variable determination of whether the organization in question had an impermissible commercial hue. Given the range of rationales and outcomes, it was impossible to nail down exactly what added up to a commercial hue, but factors included: (1) whether the organization at issue was producing substantial overall profits, (2) whether the organization was setting prices at or below the level of commercial firms, and (3) whether the organization was acting in direct competition with for-profit companies.<sup>270</sup>

In a more recent, much discussed case, the U.S. Tax Court agreed with the denial of exemption for a purportedly charitable and religious entity affiliated with the Seventh-Day Adventist Church that, as part of its church mission, maintained vegetarian restaurants and health food stores.<sup>271</sup> The court denied exemption on grounds that the activities were conducted as a business and that the organization was in competition with other restaurants and health food stores.<sup>272</sup> On appeal the U.S. Court of Appeals for the Seventh Circuit upheld the tax court opinion, finding that the organization violated the commerciality doctrine by: (1) selling goods and services to the general public; (2) engaging in direct competition with commercial stores and restaurants; (3) setting prices based on formulas common in the retail food business rather than below cost; (4) using promotional materials to increase sales; (5) maintaining regular business hours of operation; (6) paying professionals to run the operations rather than relying on volunteers; and (7) failing to elicit charitable contributions.<sup>273</sup> As in previous commerciality doctrine cases,<sup>274</sup> the court provided scant guidance as to how to determine whether a

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924 (N.D. Ind. 1967) (publication and sale of religious literature not exempt or charitable where the commercial activity (i.e., the sale of literature) was its sole activity; no mention of relatedness); *Golden Rule Church Ass'n v. Comm'r*, 41 T.C. 719 (1964) (religious organization that conducts training projects found tax exempt based on fact that it does not generate profits; no discussion of relatedness); *Am. Inst. for Econ. Research v. United States*, 302 F.2d 934 (Ct. Cl. 1962) (an organization that sells newsletters and books to subscribers containing investment advice is not charitable or educational because it competes with for-profit companies and its purpose is "primarily business"; no discussion of whether the profit-making activity was related or unrelated to the charitable mission).

270. See *supra* note 269; see also *Colombo, supra* note 183, at 502.

271. *Living Faith, Inc. v. Comm'r*, 60 T.C.M. (CCH) 710 (1990), *aff'd*, 950 F.2d 365 (7th Cir. 1991).

272. *Id.* at 713.

273. *Living Faith, Inc.*, 950 F.2d at 374-75.

274. See, e.g., *B.S.W. Group, Inc. v. Comm'r*, 70 T.C. 352 (1978) (finding, purportedly under the operational test but actually under the commerciality doctrine, that an organization providing consulting services to nonprofits engaged in rural policy and program development had a "commercial hue").

substantial unrelated purpose existed, which facts should be taken into account, and what weight the different facts should be accorded. Once again, the court failed entirely to consider whether the commercial activities in question were in furtherance of the organization's charitable purpose and thus permissible under the operational test.

The commerciality doctrine, with its evaluation of charities' commercial hue, is still very much alive, but neither the courts nor the IRS apply it consistently.<sup>275</sup> In 1984, for example, the Third Circuit reversed the revocation of exempt status for a religious publisher on facts very similar to *Scripture Press*.<sup>276</sup> The tax court had upheld the IRS's determination that the organization operated with an impermissible commercial hue, based largely on its significant profits.<sup>277</sup> The Third Circuit reversed, stating that "success in terms of audience reached and influence exerted, in and of itself, should not jeopardize the tax-exempt status of organizations which remain true to their stated goals."<sup>278</sup> Apparently, the Third Circuit correctly took into consideration that the organization's commercial activities were related to its charitable purpose.<sup>279</sup>

In several other cases, the tax court itself has seemingly contradicted its own jurisprudence by finding commercial charities exempt from taxation. For example, it was called upon to determine whether an exempt organization that imported and sold artisans' crafts could be tax exempt. The IRS contended that the organization was a commercial import firm.<sup>280</sup> The organization countered that its charitable purpose was, among other things, to help disadvantaged artisans in poverty-stricken countries subsist and preserve their craft.<sup>281</sup> The tax court agreed with the organization, finding that it engaged in the fee-generating activities not as an end in themselves but as a means of accomplishing legitimate exempt purposes.<sup>282</sup>

From the perspective of a fee-generating, entrepreneurial charity, this and similar cases<sup>283</sup> were laudable but hardly comforting since it is impossible to see in them grounds for a factual or legal distinction from opposing cases, other than that our courts and administrative

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275. See Colombo, *supra* note 183, at 503.

276. *Presbyterian & Reformed Publ'g Co. v. Comm'r*, 743 F.2d 148 (3d Cir. 1984).

277. *Presbyterian & Reformed Publ'g Co. v. Comm'r*, 79 T.C. 1070, 1088-89 (1982).

278. *Presbyterian & Reformed Publ'g Co.*, 743 F.2d at 158.

279. See *id.* at 158-59.

280. *Aid to Artisans, Inc. v. Comm'r*, 71 T.C. 202, 208 (1978).

281. *Id.* at 207-08.

282. *Id.* at 214; see Hopkins, *supra* note 2, at 638.

283. See, e.g., *Indus. Aid for the Blind v. Comm'r*, 73 T.C. 96 (1979) (finding an organization exempt in spite of profit generation where the organization's purpose was to purchase and sell products manufactured by blind individuals).

agencies like poor artisans and do not like comparatively wealthy consultants and religious book publishers.<sup>284</sup>

This brings us back to the quandary introduced at the start Part II.C.2: How can modern, entrepreneurial charities comply with a doctrine that sprang from the ether and seems to change every time it is applied, a doctrine that crept into American charity law through judges' inchoate sense that commercial activity is incompatible with tax-exempt status, even though governing statutes and regulations appear to provide the opposite? Judges and administrators apply the doctrine ad hoc, taking into account whatever facts they think are relevant, and seemingly making judgments based on how appealing they find the charitable missions of the organizations in question.<sup>285</sup> Charities subject to the doctrine find themselves in the position of having to guess how much profit they are allowed to generate before jeopardizing their tax-exempt status.<sup>286</sup> As discussed in Part II.C.5 below, this schizophrenic doctrine's existence might best be explained by the schizophrenic Anglo-American definition of charity, and the most effective cure may be a revision of that definition.

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284. For purposes of my argument, it is sufficient to demonstrate that the commerciality doctrine is vague and inconsistently applied. However, I do not want to move on without at least mentioning that there are serious logical flaws embedded within it. First, at its most general level the doctrine poses this nonsensical question: Does the commercial activity in question have a commercial hue? Given that the analysis begins with the identification of commercial conduct, it is difficult to fathom how confirmation that the activity is indeed commercial moves the inquiry in a meaningful direction or can furnish the basis of a principled judgment. Moreover, the doctrine seems downright silly when it holds that profit generation is a key factor weighing against tax-exempt status when charities' sole motivation for engaging in commercial activity obviously is to generate revenue. Why else would they do it? Finally, there is a serious logical flaw in the commerciality doctrine's mushy and ill-defined analysis of competition and the cost of services. On one hand, courts frown on exempt organizations that compete with commercial ventures. Market competition is (or at least was) considered to be strong evidence of nonexempt commercial purposes. *See, e.g., Fed'n Pharmacy Serv., Inc. v. Comm'r* 72 T.C. 687, 692 (1979); *B.S.W. Group, Inc. v. Comm'r*, 70 T.C. 352, 358 (1978). On the other hand, courts favor organizations that charge fees that are below cost, viewing this as evidence that the activities are being conducted for charitable purposes, not solely for profit. *See Peoples Transl. Serv./Newsfront Int'l v. Comm'r*, 72 T.C. 42, 49 (1979); *see also Rev. Rul. 68-306, 1968-1 C.B. 257* (granting exemption to a newspaper publisher whose subscription was not enough to cover costs of the operation). The interplay of these two factors puts charities in a no-win situation. They are expected to avoid competing with for-profit businesses offering similar goods or services, yet they are required to price their goods at discount rates to prove they are charitable. *See generally* Pena & Reid, *supra* note 176, at 1873-76.

285. *See* Pena & Reid, *supra* note 176, at 1869.

286. *See, e.g., Scripture Press Found. v. United States*, 285 F.2d 800 (Ct. Cl. 1961); *see also* Colombo, *supra* note 183, at 504-05.



### 3. Unrelated Business Income Tax

The unrelated business income tax is another perplexing doctrine that has evolved amidst our society's divided understanding of charity. In 1950, Congress passed UBIT to prevent nonprofit charities from engaging in unfair competition with for-profit enterprises. In Congress's view, formulated under heavy lobbying from small business interests,<sup>287</sup> the permissive income generation rules for charity that had arisen as a result of the *Trinidad* decision, including the destination-of-income test that allowed charities to engage in practically unlimited commercial activity,<sup>288</sup> also had permitted them to compete unfairly with for-profit enterprises. Whether or not commercial competition by charities is truly unfair,<sup>289</sup> Congress took action by adding the UBIT provision to the IRS Code.

The idea behind the passage of UBIT was that instead of banning all commercial activity carried on by charities, Congress would force them to compete fairly in the marketplace by taxing at normal corporate rates all of their profits resulting from trade or business that was not "substantially related" to the performance of their exempt purposes.<sup>290</sup> In theory, charities would continue to be free to engage in commercial activities related to their exempt purposes, although, as discussed in Part II.C.2 above, the commerciality doctrine has rendered that assumption dangerous.

More precisely, according to IRS regulations a charity's income is subject to UBIT when: (1) the income at issue results from a trade or business; (2) the trade or business is regularly carried on by the organization; and (3) the conduct of the trade or business is not substantially related to the performance by the organization of its tax-exempt functions.<sup>291</sup> Each of these three prongs is explained in pages of complicated regulations, which make difficult going for practitioners of nonprofit law and excellent material for law school essay exams. The Code and regulations also outline several important exceptions to UBIT, providing, for example, that income that otherwise would be treated as unrelated is not taxed when it results from business conducted by volunteers,<sup>292</sup> when it is conducted for the convenience of the organization's members, students, patients, officers or employees,<sup>293</sup> and when it results from thrift store sales.<sup>294</sup>

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287. See *Revenue Revision of 1942: Hearings Before the House Comm. on Ways and Means*, 77th Cong. 1612 (1942) [hereinafter *Revenue Revision*]; Colombo, *supra* note 183, at 529; Henry B. Hansmann, *Unfair Competition and the Unrelated Business Income Tax*, 75 Va. L. Rev. 605 (1989).

288. See *supra* notes 250-56 and accompanying text.

289. See *infra* notes 335-36 and accompanying text.

290. I.R.C. § 513(a) (2000); Treas. Reg. § 1.513-1(a) (as amended in 1983).

291. Treas. Reg. § 1.513-1(a).

292. I.R.C. § 513(a)(1).

293. I.R.C. § 513(a)(2).

By carefully navigating the statutory exceptions and UBIT case law, skillful attorneys and their savvy nonprofit clients have learned to structure business operations to minimize and in most cases avoid UBIT payments.<sup>295</sup> Interesting though they are, we will not spend time exploring the intricacies of UBIT or charities' creative countermeasures. Instead, we will confine our discussion to the confusing ways it influences and interacts with the operational test and the commerciality doctrine.

Although it is possible to draw logical connections between UBIT and the operational test and commerciality doctrine, neither the IRS nor the courts have defined how they interact.<sup>296</sup> Congress's adoption of UBIT logically implied that it accepted that charities would engage in commercial activities unrelated to (or, in the parlance of the operational test, not in furtherance of) their exempt purposes, and that those activities would be compatible with organizations' tax-exempt status under the operational test, so long as their primary purposes remained charitable.<sup>297</sup> However, the doctrines have never been harmonized officially, and charities still cannot predict when judges or administrators will choose to tax their income under UBIT rather than attack their tax exemptions under the operational test or the commerciality doctrine.

At least some of the confusion surrounding the doctrines stems from the fact that the determination of whether a charity must pay UBIT is evaluated based on whether its profit-generating activity is "related" to its exempt function.<sup>298</sup> The operational test, on the other hand, decides whether an organization can maintain its exempt status based on whether its "primary purpose" is charitable. The all-important but vexing question for an entrepreneurial charity trying to navigate these doctrines is whether an income-generating activity can be "unrelated" to its exempt purpose and thus subject to UBIT, but at the same time not interfere with its primary purpose such that it can still pass the operational test.<sup>299</sup> As discussed above, we know the general answer should be "yes, it is possible," because if deciding authorities were to rule that all unrelated commercial activity jeopardized tax-exempt status under the operational test, Congress's passage of UBIT would be rendered a nullity.

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294. I.R.C. § 513(a)(3).

295. See John M. Strefeler & Leslie T. Miller, *Exempt Organizations: A Study of Their Nature and the Applicability of the Unrelated Business Income Tax*, 12 Akron Tax J. 223, 272 (1996) (suggesting charitable organizations can avoid paying UBIT by regularly updating their mission statements to encompass their commercial activities).

296. See Pena & Reid, *supra* note 176, at 1884.

297. See Treas. Reg. § 1.501(c)(3)-1(c)(1), -1(e)(1) (as amended in 1990).

298. See I.R.C. § 511(a); Treas. Reg. § 1.512(a)(1) (as amended in 2002).

299. As discussed in Part II.C.2, *supra*, an organization engaged in commercial activity that passes the operational test must under existing law still be wary of the commerciality doctrine.

How then should the doctrines be harmonized? Once an examining court or administrative authority has determined that a charity is engaged in an unrelated business activity, it should begin by taxing the profits under UBIT. It should then go on to determine under the operational test whether the unrelated commercial activity is so substantial that the organization's "primary purpose" has been compromised. Only if the answer to the latter question is affirmative should the authority disqualify the organization.

Unfortunately, this is not how decision-making authorities have applied the doctrines. Although the IRS formally recognizes that there is a relationship between the operational test and UBIT,<sup>300</sup> it routinely makes UBIT determinations without raising the question whether the charity should lose its exempt status under the operational test or the commerciality doctrine.<sup>301</sup> Its consistent litigation strategy has been to present cases as either under the operational test, commerciality doctrine, or UBIT, such that courts rarely have the opportunity to consider the relationship between the doctrines and no case law has developed to guide entrepreneurial charities.<sup>302</sup> As a result, there is no way for charities to know how much unrelated commercial activity they may engage in without jeopardizing their tax-exempt status.

As was true when discussing the operational test and commerciality doctrine, the explanation of the confusion over UBIT and a solution to the problem may be found in the history of charity.

#### 4. The Commensurate-in-Scope Doctrine

In this incompatible patchwork of laws and regulations governing entrepreneurial charities, the commensurate-in-scope doctrine has evolved and is sometimes relied upon to fill in the practical and logical holes created by the other doctrines. We will confine our discussion of commensurate-in-scope to a few words.

The commensurate-in-scope doctrine suggests that a key issue in determining if substantial unrelated business activity (or, in terms of the operational test, substantial activity not in furtherance of the exempt purpose) is consistent with the organization's underlying exemption is whether the revenue from such commercial activity is spent to further the organization's charitable purpose.<sup>303</sup> In other

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300. See Priv. Ltr. Rul. 94-36-002 (Jan. 26, 1994).

301. See Pena & Reid, *supra* note 176, at 1885; see, e.g., Priv. Ltr. Rul. 98-22-006 (Jan. 29, 1998); Priv. Ltr. Rul. 97-03-025 (Oct. 21, 1996); see also *Carle Found. v. United States*, 611 F.2d 1192 (7th Cir. 1979) (IRS contending that pharmacy sales to the general public were unrelated business income to an exempt hospital without raising the question of whether unrelated sales might lead to loss of exemption).

302. See Colombo, *supra* note 183, at 508; Pena & Reid, *supra* note 176, at 1883-84.

303. See Rev. Rul. 64-182, 1964-1 C.B. 186-87 (introducing the doctrine in a matter involving a charity that derived revenues from unrelated rental income).

words, if the reviewing authority applying the doctrine finds that the organization's charitable program is "commensurate in scope" with its financial resources, it will uphold the organization's exemption even if the money is being produced through an activity that has nothing to do with the charitable mission. Although the doctrine was first enunciated in a 1964 Revenue Ruling,<sup>304</sup> the IRS recently has been relying on it more frequently to determine whether charities that engage in commercial activities unrelated to their missions should lose their tax exemptions,<sup>305</sup> and some commentators argue that the doctrine has begun to replace the primary purpose analysis of the operational test.<sup>306</sup>

The rise of commensurate-in-scope is relevant to our historical analysis of charity law in two respects. First, it might offer a partial explanation of many of the seemingly inexplicable commerciality doctrine cases, even though it was never mentioned as grounds for these decisions.<sup>307</sup> For example, in the *Aid to Artisans, Inc. v. Commissioner* case an organization that produced significant income from selling goods produced by poor artisans from other countries was permitted to keep its tax exemption where most of the profits being generated by the commercial activity were being ploughed back into the organization's charitable work.<sup>308</sup> Similarly, in *Industrial Aid for the Blind v. Commissioner*, an organization that purchased and sold goods made by blind individuals was able to maintain its exemption where the facts indicated that most of the income went to fund the organization's charitable mission.<sup>309</sup> In contrast, religious publishers such as Scripture Press that appeared to the court to be hoarding profits and paying employees high salaries without spending significant sums on activities that were traditionally charitable lost their exemptions.<sup>310</sup>

Second, it is worth noting that the commensurate-in-scope doctrine appears to have much in common with the old destination-of-income test.<sup>311</sup> Under both, courts and administrators seem to be comfortable saying that so long as the money is going to serve genuine charitable purposes, we do not really mind that it is being produced by unrelated commercial activity. The difference, of course, is that under the

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304. *Id.*

305. *See, e.g.*, Priv. Ltr. Rul. 200-21-056 (Feb. 8, 2000) (income from tearoom unrelated to charitable purpose is subject to UBIT but does not invalidate exempt status where profits were used to fund charitable activities); Tech. Adv. Mem. 96-36-001 (Jan. 4, 1995) (religious publisher is subject to UBIT but not loss of exemption where funds were used to support educational mission).

306. *See Hopkins, supra* note 2, at 75.

307. *See Colombo, supra* note 183, at 513.

308. *Aid to Artisans, Inc. v. Comm'r*, 71 T.C. 202 (1978).

309. *Indus. Aid for the Blind v. Comm'r*, 73 T.C. 96 (1979).

310. *Scripture Press Found. v. United States*, 285 F.2d 800 (Ct. Cl. 1961).

311. *See supra* notes 255-56 and accompanying text.

destination-of-income test, the organization producing the income escaped taxation, whereas, under the combination of UBIT and the commensurate-in-scope doctrine, unrelated income is taxed at normal corporate rates. Still, both doctrines allow judges and administrators to do what they have been chafing to do since the earliest reported American legal decisions on charity: permit and even encourage commercial activities that support vulgar charity while squelching money-making activities that do not look and smell sufficiently charitable.

## 5. Summary and Conclusion

From the beginning, American charity law has been premised on an inconsistent understanding of what charity means: aid to the poor based on indiscriminate compassion, or social engineering grounded in the Protestant work ethic. The division can be detected in the earliest state law decisions and throughout the development of the federal tax law pertaining to charity.

This definitional uncertainty has led to contemporary legal doctrines that are vague and unworkable. Judges and administrators apply the closely related operational test and commerciality doctrine interchangeably to grant or revoke charitable exempt status based on an ever-shifting array of factors that seem to boil down to whether the mission and activities of the organization in question are appealing. Judges often find commercial activity unappealing and thus unlawful, particularly where the charity's mission focuses more on public benefit and social engineering than service to the poor.

The commensurate-in-scope doctrine is sometimes (but sometimes not) applied in place of the operational test's "substantiality" determination. Its role appears to be to permit decision makers to approve of charitable status for commercial charities that have appealing missions and that spend most of their commercially raised funds on their charitable purposes.

UBIT springs from a firm statutory base but adds to charities' confusion because no one can reliably predict where taxation under UBIT ends and revocation of exempt status under the operational test and commerciality doctrine begins. Further complicating the application of UBIT, many charities and judges have difficulty determining which activities are "substantially related" to their charitable purposes in a context where no one is quite sure what charity really means. From the perspective of charities, particularly entrepreneurial, income-generating charities, decision makers wield the law arbitrarily, limiting the entrepreneurial activities of charities that come before them based solely on their intuitive sense that commerce and charity are incompatible.

An explanation of the muddled American law of charity can be found in our history. Our cultural and legal definition of charity has evolved since the time of Henry VIII and Elizabeth I to encompass a broad array of socially-beneficial activities that have nothing to do with aiding the poor and needy. But in spite of that evolution, judges, administrators, and policymakers have never abandoned the older, stricter conception of charity as aid to the poor and distressed. Without articulating what they were doing, perhaps without even realizing it, American decision makers have consistently tugged the law back toward its vulgar roots. When a charitable organization today engages in what an administrator or judge feels is too much commerce—particularly where that organization combines commerce with a charitable mission that does not focus on aiding the poor and distressed—that administrator or judge will grasp for a legal mechanism to draw charity back toward its compassionate, Judeo-Christian origins.

But our federal tax law, which is now the de facto policing agency for most American charities,<sup>312</sup> lacks a legal category or language to describe the sort of compassion-based, poverty-focused activity that comprises the roots of vulgar Anglo-American charity. Judges find themselves relying on vague and malleable legal doctrines such as commerciality, and vaporous legal tests such as “all the circumstances,” to permit them to act on their intuitive beliefs that charity is about loving and serving the poor and distressed, regardless of what the IRS Code says about the permissibility of general “public benefit” and commercial activities.<sup>313</sup> This exercise of judicial intuition makes for bad law.

In the end, all that modern, entrepreneurial charities can garner from the confusing welter of doctrines that spring from our divided history of charity is that courts and the IRS will accept some measure of commercial activity, and that they are likely to permit more such activity if the charitable work of the organization at issue is appealingly vulgar, and if a high percentage of the funds being produced as a result of the commercial activity is being spent on the appealing charitable mission. Beyond that, charities can predict little.

The IRS has on at least one occasion owned up to its part in the confusion. In a 1971 General Counsel’s memorandum it declared:

[F]or some time now it has been increasingly apparent that our earlier approach to the problem of permissibility or non-permissibility of business activities of charities has been based on a misconception that somehow in the enactment of the provisions for exemptions of charities from income tax, Congress intended an

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312. See *supra* note 4.

313. See Hopkins, *supra* note 2, at 829 (arguing that judges take “intuitive offense” at the notion that a charity is doing something that more properly belongs in the domain of for-profit organizations); see also Pena & Reid, *supra* note 176, at 1868-69.

implied restriction on the extent of their engagement in business activities. In the years past, the Service sought by ruling and by litigation to deny the right of charities to engage in business, insisting that somewhere, somehow in the enactment of the exemption provisions Congress must have intended to limit the classification of exempt charities to those charities not engaged to any substantial extent in commercial endeavors.<sup>314</sup>

These wise words could have added clarity to the government's regulation of charities, but they apparently were ignored by IRS litigators and courts, who continue, decades later, to challenge the notion that entrepreneurial, fee-generating organizations—especially those that do not serve the poor and distressed—can be charitable.<sup>315</sup>

### III. WHAT IS TO BE DONE?

In Part I of this Article we saw that the Anglo-American cultural and legal definition of charity came to encompass two very different notions: aid to the poor on one hand and social engineering for the benefit of the general public on the other. The former insisted on compassionate help for those in need regardless of their worthiness while the latter emphasized the importance of work and held that the “sturdy poor” could justly be left to starve. Both understandings of charity persisted through the late Middle Ages, and were transferred to the New World.

In Part II, we traced the development of the American law of charity and showed that its split definition led to inconsistent treatment in early case law, and, more recently, to incoherent federal legal standards. From our earliest history, charitable organizations have been pushed to engage in ever more social engineering and poverty management—often paying their own way by engaging in commercial activity—while judges and administrators, who have taken intuitive offense at this commercialization, have worked to tug charity back toward its compassionate, poverty-focused roots. The result has been confusion, particularly in recent years, as changes in government policy and funders' expectations have compelled charities to turn more aggressively toward the marketplace.

In Part III of this Article, we will address briefly the question of what is to be done: whether there is a sensible way out of our present fix in which charities are compelled by government policy and societal preference to become entrepreneurial and self-supporting, but are arbitrarily penalized by the law for doing so. The discussion below does not offer a fully formed statutory scheme, but rather a broad suggestion for appropriate reform formulated in light of American charity's complicated history and present legal fix.

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314. Gen. Couns. Mem. 34,682 (Nov. 17, 1971).

315. See Colombo, *supra* note 183, at 511.

### A. *A Reformed Legal Definition of Charity*

American charity laws are confused and confusing because of the inconsistent cultural and legal definition of charity itself. Why not then alter the definition of charity, at least for purposes of federal tax law, in a way that both honors and clarifies our divergent traditions?

Let us create a new subcategory of charitable organizations—call them vulgar charities—whose missions and resources are devoted exclusively to serving the poor. We must leave as a matter for debate and statutory drafting exactly which organizations will qualify for this designation and which will not, but we can begin here by sketching the broad outlines.

Most organizations that today obtain tax exemption under section 501(c)(3) as “public benefit organizations” will not qualify as vulgar charities. Thus, health care organizations and educational institutions that serve the general public and do not focus on the poor will not qualify. Nor will arts programs geared toward the general public, middle- and upper-class neighborhood associations, garden societies, symphony orchestras, the Boy or Girl Scouts of America, or YMCAs that cater to fitness buffs in upscale communities.

The category of vulgar charities would include the panoply of organizations whose missions involve serving the poor. Job training programs, community economic development and low-cost housing organizations that focus on disadvantaged neighborhoods, boys’ and girls’ clubs in low-income communities, no-cost and low-cost community-based health clinics, organizations that serve poor artisans from developing countries, and of course soup kitchens all would qualify.<sup>316</sup> In effect, the new category would group together those organizations that judges and administrators long have been intuitively grouping together and protecting by finding reasons to give them a “pass” under incoherent legal doctrines such as commerciality.

Concrete advantages would accrue to those charitable organizations deemed vulgar. The vagaries of contemporary tax law doctrines

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316. Formulating the precise contours of the new legal category will prove challenging. Defining “poor” is relatively straightforward: Regulations already exist that define poverty as a percentage of median income. Such definitions are frequently relied upon by, among others, organizations that develop low-income housing. A more difficult policy question would arise as to whether the new legal category should include not only the poor but also the “distressed.” If this new category is to remain consonant with history, any broadening of the category of “distressed” would have to be confined to people who are incapable of helping themselves. Thus, an organization such as the Betty Ford clinic that helps wealthy addicts face their addictions would not qualify, because their clients typically can afford to pay for high-priced treatment. On the other hand, a drug rehabilitation facility aimed at low- and moderate-income individuals—those who typically could not afford to pay for such services—might qualify. Similarly, elder-care organizations geared toward the well-off would not qualify as vulgar, while those dedicated to caring for low- and moderate-income individuals could.



would disappear, and they would be governed by the permissive destination-of-income test that was launched in the wake of the *Trinidad* opinion and later squelched by the commerciality doctrine and UBIT.<sup>317</sup> Those charities devoted to serving the poor would be given broad latitude to earn income to support their missions in whatever way they decide. Traditional charities could launch fee-generating enterprises related to their charitable missions (which, under existing federal law they should be able to do anyway, notwithstanding the commerciality doctrine),<sup>318</sup> but they also could choose to launch unrelated businesses to cross-subsidize their charitable work. Such organizations would continue to answer to regulators under intermediate sanctions,<sup>319</sup> the private inurement doctrine,<sup>320</sup> and the operational test<sup>321</sup> to ensure that the profits generated by their enterprises were in fact going to serve the poor; however, these charities would no longer live under the vague and confusing specter of commerciality, UBIT, and commensurate-in-scope.<sup>322</sup>

This refined definition of charity would have several salutary effects. First, it would create a more consistent and predictable legal framework in which vulgar charities could plan and carry out their missions. Rather than struggling with a legal regime in which judges and administrators make ad hoc decisions regarding charitable status, twisting the law to satisfy their and society's intuitive sense that there ought to be a special place for charity directed toward the poor, the new definition would create a legally recognized and favored category so that they (the judges) and we (society) could do it explicitly and consistently. This new legal category would acknowledge that the work of serving the poor needs to be done (even if only by creating the conditions under which the poor and distressed can help themselves), that few are willing to pay for it with their tax dollars, that charities are being forced to embrace entrepreneurial solutions to pay their own way, and that it is simply wrong to insist that charities adopt the methods and ethos of commerce while at the same time punishing them for doing so.

Such a reform also would be consonant with our multifarious history of charity. Instead of chafing against history, this reform would embrace it and allow it to strengthen our law. This new

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317. See *supra* notes 253-61 and accompanying text.

318. See *supra* Part II.C.2.

319. See I.R.C. § 4958 (2000).

320. See Treas. Reg. § 1.501(a)-1(c) (as amended in 1982).

321. See Treas. Reg. § 1.501(c)(3)-1(c) (as amended in 1990).

322. Other commentators have advocated simplifying or eliminating aspects of the operational test. See, e.g., Colombo, *supra* note 183, at 549 (suggesting reforming the operational test to include a bright line measure of charitability by examining charities' gross expenditures and comparing related and unrelated activity); Pena & Reid, *supra* note 176, at 1863 (same).

definition would acknowledge that, in spite of the passage of five hundred years since the Church of England began to pull charity from its Judeo-Christian roots, the ancient tradition of charity as succor to the poor persists as an important cultural value. At the same time, the proposed reform would leave in place the broader, common law definition of charity provided by the Statute of Charitable Uses,<sup>323</sup> Lord McNaughten's case,<sup>324</sup> and, since the IRS administratively revised American law in the early 1950s,<sup>325</sup> the Federal Internal Revenue Code.<sup>326</sup> The category of "non-vulgar charities" would include everything that today qualifies under section 501(c)(3), minus the vulgar charities, which would enjoy their own more privileged category.

Finally, the reform would acknowledge the role that work and commerce play in the realm of American charity. It would take account of the historical truth that, since the earliest Anglo-American charity laws, our society and legal system have considered commercial enterprise an acceptable, even laudable tool for addressing the needs of the poor, though not necessarily of serving the public benefit. Likewise, it would acknowledge that in recent years the phenomenon of adopting commerce as a tool for achieving charitable ends has moved, for better or worse, to the center of American charity.

This definitional reform, proposed here in broad outline, would add clarity and consistency to American law by bringing our legal system into closer conformity with our society's historic and contemporary

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323. *See supra* notes 75-76.

324. *See supra* note 77.

325. *See supra* notes 220-22 and accompanying text.

326. Those organizations that qualify under today's standards for section 501(c)(3) tax exemption but do not qualify under the proposed category of "traditional charities" would continue to live under the rules they live by today, although those rules also could benefit from substantial reform. The notorious commerciality doctrine would be a good place to begin. Although an ideal course of action would be to entirely scrap commerciality, it is difficult to see how that could be accomplished elegantly after more than fifty years of case law. An acceptable alternative would be to ask Congress to codify the doctrine, making it clear that although commerciality (along with UBIT) was developed to prevent charities from unfairly competing with for-profit enterprises, that reasoning was flawed and should no longer be even nominally part of the legal analysis. Second, a codification of the commerciality doctrine should make clear that it does not exist to ensnare legitimate charities that generate income—even significant amounts of income—from commercial activities that are related to, and in furtherance of, their charitable missions. Finally, a codification and improvement of commerciality would make clear that it is rooted firmly within the IRS's operational test, rather than being a free-floating doctrine to be used at the whim of judges and administrators. As such, the commerciality doctrine's sole function would be to police the boundary between permissible unrelated income-generating activity subject to UBIT, and impermissible unrelated income-generating activity that jeopardized the organization's exemption. In other words, the commerciality doctrine would become the means by which judges and administrators would decide whether commercial activity had become the organization's primary purpose.

conception of charity. It would satisfy our society's obligation to provide for the poor, even if only by permitting the poor to provide for themselves without interference. Perhaps most important, it would solve a knotty legal problem by eliminating judges' intuitive need to invent or twist doctrines to winnow inappropriately commercial charities from the rest.

*B. Objections to the Proposed Reforms: Unfair Competition, Tax Base Erosion, Loss of Halo Effect*

Altering the legal definition of charity would not be a simple process. In addition to the challenge of drafting a workable definition of vulgar charity,<sup>327</sup> any reform that has the effect of permitting charities to engage more freely in commercial activity will meet with strenuous objection, mostly from outside the world of charity. Three objections merit special attention.

1. Unfair Competition

If recent history is a guide, the earliest and loudest objections will come from for-profit businesses.<sup>328</sup> Since the *Trinidad* case launched the era of nonprofit "feeder" corporations,<sup>329</sup> business interests have protested what they claim is unfair competition coming from nonprofit charities that engage in commerce.<sup>330</sup> This alleged unfairness was a prime justification leading to the passage of UBIT in 1950.<sup>331</sup> Then as now,<sup>332</sup> the for-profit business community's objections focus on two nonprofit tendencies that it deems unfair. First, for-profits claim that charitable, tax-exempt businesses engage in predatory pricing, using their comparative advantage—a lighter tax burden—to unfairly lower their prices and steal clients from for-profit firms.<sup>333</sup> The second, related, objection is that nonprofit charitable organizations, which enjoy comparatively large profit margins due to their tax-advantaged status, plough those marginal profits into market expansion, aiming to squeeze out for-profit businesses.<sup>334</sup>

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327. See *supra* note 316.

328. See Office of Advocacy, U.S. Small Bus. Admin., *Unfair Competition With Small Business* (1986); Hansmann, *supra* note 287, at 605.

329. See *supra* notes 255-56 and accompanying text.

330. See *Revenue Revision*, *supra* note 287; see also Colombo, *supra* note 183, at 529.

331. See S. Rep. No. 85-2375, at 28-29 (1950); H.R. Rep. No. 85-2319, at 36-37 (1950); see also Colombo, *supra* note 183, at 529.

332. See *Unrelated Business Income Tax: Hearings Before the Subcomm. on Oversight of the House Comm. on Ways and Means*, 100th Cong. 98-99 (1987) (statement of Frank S. Swain, Chief Counsel for Advocacy, U.S. Small Business Administration).

333. See Colombo, *supra* note 183, at 529-31.

334. See *id.*

Although Congress seems to have found these claims of unfair competition persuasive,<sup>335</sup> commentators have not. There is seeming unanimity among legal academics and economists who have wrestled with the unfairness issue that although competition from non-profit enterprises may be unwanted by for-profit businesses, it is not unfair.<sup>336</sup> In lay terms, they found that the goal of nonprofit managers who engage in commercial activity is to produce revenue to subsidize their charitable missions. Because their goal—just like for-profit businesses—is to maximize revenue, they have no motivation to charge anything lower than what the market will bear. There simply is no theoretical or empirical basis for the claim of price gouging.<sup>337</sup> Similarly, studies find no empirical evidence to support claims of unfair, subsidized market expansion. They suggest that charitable managers, rather than scheming to undercut for-profit competition, expand market share and force for-profit operators out of business, do exactly what we would hope they would do: They maximize their profits and devote them to serving their charitable missions.<sup>338</sup>

There is also a broader policy argument that undercuts for-profit business' objections to entrepreneurial charities. It is the same argument we have mentioned above and will mention below: It simply is not fair for our society to tell charities that they must fend for themselves by competing in the market, and at the same time force them to compete wearing the shackles of the charity law doctrines.

It may well be true that policy decisions taken since the Reagan era to shift the cost of caring for the poor away from government and toward the free market have placed a disproportionate share of that burden on owners of for-profit businesses that supply goods and services to the general public. As discussed above, they will not face unfair competition as a result of this shift, but they may face more competition. If we as a society find this burden shifting unacceptable,

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335. It is difficult to judge the precise degree to which Congress was persuaded. Although the legislative history accompanying UBIT states clearly that unfair competition was a prime motivation behind its passage, the legislation as passed focused the inquiry on whether or not the activity at issue was related to the organization's charitable mission. Competition with for-profit firms is not, and never has been, included as part of the legal analysis. See I.R.C. § 513(a) (2000); Treas. Reg. § 1.513-1(a) (as amended in 1983).

336. Colombo, *supra* note 183, at 530; see Boris I. Bittker & George K. Rahtert, *The Exemption of Nonprofit Organizations from Federal Income Taxation*, 85 Yale L.J. 299, 318-25 (1976); William A. Klein, *Income Taxation and Legal Entities*, 20 UCLA L. Rev. 13, 61-68 (1972) (arguing that Congress's passage of UBIT was a response to the "paranoid delusion" of unfair competition); Susan Rose-Ackerman, *Unfair Competition and Corporate Income Taxation*, 34 Stan. L. Rev. 1017 (1982).

337. See Hansmann, *supra* note 287, at 610-12.

338. See Burton A. Weisbrod, *Modeling the Nonprofit Organization as a Multiproduct Firm: A Framework for Choice*, in *To Profit or Not to Profit*, *supra* note 192, at 47. It should not be forgotten that legal doctrines exist—intermediate sanctions, private inurement, the operational test—to identify and punish organizations that act as nonprofits in disguise.

we can debate whether to shift it back to the government or to some other sector of society. Until and unless that happens, we should not be persuaded by arguments that, in essence, complain that nonprofits are sometimes beating for-profit enterprises at their own game.

## 2. Tax Base Erosion

In 1993, a series of investigative articles ran in the *Philadelphia Inquirer* documenting waste, fraud, and abuse in the nonprofit sector. Among other condemning facts, the authors reported that the nonprofit sector's activities cost the country over \$36 billion per year in lost revenue due to the tax-exempt status of nonprofit organizations.<sup>339</sup> When regulation of the nonprofit sector is debated in Congress, tax base erosion is always high on the list of concerns.<sup>340</sup>

It is not only lawmakers who worry about broad tax exemptions for charities. Economists and lawyers have put forward arguments to demonstrate that subsidizing charitable activity through tax exemption is an economically inefficient means of accomplishing socially necessary ends. They suggest that we as a people would spend our money more wisely if we directly subsidized socially necessary and useful charitable activities.<sup>341</sup> It is beyond my ken and beyond the scope of this Article to grapple with those economic efficiency arguments, but it may also be unnecessary.

A debate over economic inefficiency is unnecessary because if we as a society have formed a political consensus on any issue in recent decades, it is that we prefer not to provide social services through the mediating influence of the government.<sup>342</sup> We prefer that the work of aiding the poor and distressed pay for itself, and to the extent it cannot and government must step into the fray with funding, we prefer to furnish that funding directly to consumers and let service providers compete against one another in the market for those scarce funds.<sup>343</sup>

Having made the choice as a matter of policy and politics that we would not directly subsidize charitable work but would indirectly support its socially beneficial work by exempting it from taxation, it simply is not acceptable to critique the system as eroding the tax base.

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339. Gilbert M. Gaul & Neill A. Borowski, *Nonprofits: America's Growth Industry*, Phila. Inquirer, Apr. 18, 1993, at 1 (the first in a series of articles presented under the title *Warehouses of Wealth*, beginning April 18, 1993 and continuing through April 23, 1993).

340. See *Unrelated Business Income Tax: Hearings Before the Subcomm. on Oversight of the House Comm. on Ways and Means*, 100th Cong. 98-99 (1987); *Revenue Revision*, *supra* note 287; S. Rep. No. 85-2375, at 28-29 (1950); H.R. Rep. No. 85-2319, at 36-37 (1950).

341. See generally Colombo, *supra* note 183, at 538-44.

342. See *supra* Part II.C.

343. See *supra* notes 162-63 and accompanying text.

The work of supporting and providing for the poor and distressed, and the work of accomplishing social benefits not provided by the market, is expensive. We can pay for it through direct subsidies. We can pay for it by the indirect subsidy of a tax exemption. But what we cannot do, or at least should not do, is decide to keep charities alive through indirect subsidy of tax exemption, and then complain that the indirect subsidy is overly burdensome.

### 3. Loss of the Halo

Arguments attacking broad charitable tax exemptions on grounds of unfair competition and tax base erosion generally come from outside the world of charity. However, the proposed notion of taking the fetters off of vulgar charities and permitting them to raise operating funds in whatever commercial manner they please would also face criticism from within the world of charity.

The critique from within harkens back to charity's pre-Reformation roots described in Part I.A.1 of this Article. In essence, it is that the charitable sector has always acted and should continue to act as a guardian of values in our society.<sup>344</sup> Charity plays a vital role in our culture because people trust it: They trust that charitable organizations are motivated by love and compassion, not by desire for lucre.<sup>345</sup> If we permit charitable organizations to engage in unfettered commercial activity, the argument goes, the boundaries that exist between the worlds of charity and for-profit businesses will fade.<sup>346</sup> Inevitably, commercial activity will displace charity's core values of compassion and love, and society will cease to view the sector as a special guardian of our cherished values.<sup>347</sup> Once this happens, people will no longer be willing to donate their hard-earned money to charities, and, eventually, will be unwilling to support tax exemptions to enable their work.

Responses are varied. Evelyn Brody and others have produced a body of work arguing that the sectoral boundaries between for-profit and charity are largely illusory, and that rational public policy should move toward funding socially beneficial work regardless of whether it springs from the commercial or charitable sector.<sup>348</sup> Others have

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344. See *supra* notes 194-96 and accompanying text; see also *The Resilient Sector*, *supra* note 158, at 11.

345. See Clotfelter & Ehrlich, *supra* note 192, at 511; Janne G. Gallagher, *Peddling Products: The Need to Limit Commercial Behavior by Nonprofit Organizations*, 12 *Exempt Org. Tax Rev.* 1007, 1014 (1995).

346. Clotfelter & Ehrlich, *supra* note 192, at 511.

347. See Colombo, *supra* note 183, at 534 (referring to the "diversion problem" argument, by which the attention of charity managers is diverted from core charitable missions to commercial activity).

348. Evelyn Brody, *Agents Without Principals: The Economic Convergences of the Nonprofit and For-Profit Organizational Forms*, 40 *N.Y.L. Sch. L. Rev.* 457, 461, 535-36 (1996).

produced empirical research to indicate that charity managers are in fact able to continue to focus on their core charitable missions while raising money through commercial enterprise.<sup>349</sup> Thus, it may be possible for charity to continue to wear its halo and maintain its trusted status even if it does continue to turn toward the market.

Ultimately, however, the response to this critique is that the horse is out of the barn. As described in detail in Part I of this Article, for hundreds of years Anglo-American charity has embraced work and commerce as vital tools for achieving charitable ends, and recent American history has pushed charity decisively toward the market. This insistence on entrepreneurship and profit-making among charities may prove to be a positive development or a negative development, but it is a development that seems bound to continue, and charities and the rest of society must acknowledge that fact and make adjustments in our law to fit the reality we have created.

#### CONCLUSION

This Article has argued that we in the United States, particularly those of us who pay attention to our laws and legal system, should not continue to do what we are doing: We should not as a society continue to push charitable organizations toward the free market and the ideal of financial self-support while permitting our legal system to threaten them and punish them for doing so.

Before drawing the discussion to a close, it is important to run through a few conclusions for which this Article does not stand. First, although it suggests creating a new category of vulgar charities, this Article should not be read as supporting the proposition that we in America would be better off hewing more closely and exclusively to a spiritually infused, compassion-based version of charity. There are compelling arguments to the contrary: That such charity is inevitably donor-focused; that it tends to be condescending and rob initiative from the people it purports to serve; and that it takes the fight out of young idealists from the wealthier classes, who come to believe that spooning soup at the local homeless shelter is the most powerful, if not the only, action they can take to affect the plight of the poor and distressed.<sup>350</sup> This Article only makes the point that such charity is an enduring part of our culture. It has not disappeared in the centuries since the English Reformation, it is unlikely to disappear in the near future, and therefore American charity law should take account of it.

Similarly, this Article should not be read as supporting the policies that were launched during the Reagan administration and maintained in one form or another through subsequent administrations that, at least rhetorically, left the work of supporting the poor and distressed

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349. See, e.g., Weisbrod, *supra* note 192, at 47-64.

350. See generally Wagner, *supra* note 6, at 173-74.

to well-meaning volunteers.<sup>351</sup> Person-to-person, voluntary charity can accomplish good work on behalf of those in need, and it is at the heart of those communitarian values that remain in our society, but it is not and never will be sufficient to serve the legitimate needs of those at the bottom who are searching for ladders or the materials to build their own.<sup>352</sup>

Finally, although in this Article I describe the increasing commercialization of American charity and argue that our law should adapt to accommodate the trend, I do not intend to take the position that this increasing commercialization of charity is an entirely laudable trend. Good may come from it. Infusing charity with a spirit of entrepreneurship opens up exciting possibilities for people of limited wealth and power to take charge of their futures and improve their own lots. Because self-supporting charities receive less financial input from government and philanthropy, they are less beholden to those actors' priorities and better able to develop strategies and programs that appropriately serve their stakeholders' needs. However, I share concerns, described in Part II.B.3 above, about losing public trust for the charitable sector. There is something more than sentimental longing in the claim that charity creates a space within our society where the cooperative instincts hardwired within us are honored and supported. Along with the judges and administrators whose legal rulings I criticized above, I carry within me an instinctual sense that we as a society ought to maintain a sector in which values of compassion, love, and communitarian spirit are paramount, a sector that society can trust to focus on the needs of the least of us rather than on generating profits.

What this Article does stand for is one fairly narrow proposition: We should act now to eliminate the legal double bind that we have created for contemporary American charities. If we take it as a given that society in general and our government and philanthropic community in particular will continue to expect charities to be entrepreneurial and self-supporting, then we should not allow our legal system to threaten and to penalize them when they comply with those dictates. I have proposed one way out of this double bind of creating the category of vulgar charity. It would call on us to acknowledge that Anglo-American history has left us with a split definition of charity. It would further require acknowledging that our culture and our law long ago began to insist upon work and enterprise

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351. See *supra* notes 167-69 and accompanying text. Each administration has couched this desire to return to vulgar, compassionate charity in different rhetorical guises. The phrase described George H.W. Bush's yearning for vulgar charity as "points of light." The Clinton administration combined the spirit of volunteerism with government funding and private sector methodologies under the rubric of AmeriCorps. George W. Bush added a more evangelical twist to his administration's push for vulgar charity with his Faith Based Initiative.

352. See Wagner, *supra* note 6, at 165-68.



as means of accomplishing charitable ends. Next, it would require us to acknowledge that judges and administrative authorities have repeatedly shown that they are comfortable permitting charities to engage in commercial enterprise, so long as the resulting profits serve vulgar, not merely public-benefit, charitable purposes, even though there is no clear legal doctrine that permits them to draw this distinction. Finally, it would mean surrendering to this tension by creating a new legal category of vulgar charities that would permit charities working on behalf of the poor to engage openly in commerce, and would free courts and administrators to focus on charitable organizations that fall into the more general public-benefit classification.

*Notes & Observations*