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Zolt, Eric M

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Tax Deductions for Charitable Contributions: Domestic Activities, Foreign Activities, or None of the Above

ERIC M. ZOLT*

Warren Buffett, Bill Gates, and sixty-seven other billionaires have pledged to give a majority of their wealth for charitable purposes. The total dollar amount of potential funding for charitable activities is staggering. So is the potential loss of tax revenue. Because of past, current, and future tax benefits, U.S. taxpayers have funded and will fund a substantial portion of these charitable activities without any input in how the money is spent. These billionaires are not just being generous with their own money, but with the money of the American people.

Should we allow tax benefits to subsidize charitable activities and allow donors to dictate how funds are spent? This Article seeks to contribute to the debate on the desirability of charitable tax deductions by focusing on a smaller part of the charitable tax world: charitable deductions for foreign assistance. Tax benefits for foreign assistance raise several of the same issues that arise in the purely domestic context, as well as issues that may be less important or absent in the subsidizing of domestic charitable activities.

Recent scholarship has argued for continuing to allow tax benefits to foreign charitable activities, and for extending charitable tax benefits to foreign charities and to for-profit entities engaged in charitable activities. These arguments rest partly on the notion that there is no meaningful way to distinguish these activities or entities from domestic charities engaged in domestic charitable activities. These scholars may be right in arguing for consistent tax treatment for domestic and foreign charitable activity, but they may be wrong in their conclusions. The best approach may be to consider changes to the current charitable-deduction regime for both domestic and foreign charitable activities and to consider other alternatives for the government to provide financial support and other incentives for charitable activities.

* Michael H. Schill Distinguished Professor of Law, UCLA School of Law.

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Table of Contents

Introduction 362
I. The Charitable Tax Landscape 369
II. Should Tax Benefits Support Charitable Activities Outside the United States? 377
A. General Considerations 377
B. Tax Scholarship 381
1. Donor-Oriented Approaches 381
2. Subsidy-Oriented Approaches 382
III. Should the Tax System Treat Foreign Charities Differently from Domestic Charities? 390
A. General Considerations 390
B. Consequences of Extending Tax Benefits to Foreign Charitable Activities 394
1. Effects on Quality and Quantity 394
2. Interaction with Other Providers 395
3. Substitution Away from Domestic Charities 396
IV. Should the Tax System Extend Tax Benefits to For-Profit Entities Engaged in Charitable Activities, Including Foreign For-Profit Entities? 396
A. Tax Benefits for For-Profit Charities 397
B. For-Profit Charities and Foreign Charitable Activities 399
Conclusion 401
Appendix A: Individuals Signing the Giving Pledge and Estimates of Current Wealth 405
Appendix B: Household Giving by Subsector of Income and Charity Type ($ in Billions) 407
Appendix C: Distribution of U.S. Nonprofit Charitable Assistance Efforts by Region 408
Appendix D: Types of Foreign Charitable Activities Supported by U.S. Nonprofit Organizations 409

Introduction

Linda Evangelista, the Canadian supermodel, once famously noted that she and fellow supermodel Christy Turlington did not wake up for less than $10,000 a day, then the top rate for going down the catwalk.[1] I

1. Jackie Bolin & David Ninh, *Learning Fashionese: You, Too, Can Speak Like a Fashionista*,

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admire her candor. Economists refer to this as the "reservation wage"—a useful concept in thinking about the labor-leisure trade-off.[2] I have often wanted to ask Ms. Evangelista whether the $10,000 was before or after taxes.[3]

Warren Buffett, Bill Gates, and sixty-seven other billionaires[4] have pledged to give a majority of their wealth for charitable purposes.[5] Like many others, I admire their generosity and their willingness to give back to a society that has helped them achieve their success. And again, I want to ask these individuals whether the amounts pledged are calculated before or after taxes. The difference is substantial. Even with the extended Bush tax cuts and the new estate tax regime, past, current, and future income, gift, and estate tax benefits may result in tax subsidies between 35–70% of the amounts contributed.[6] A rough calculation for these sixty-nine billionaires yields a potential loss of tax revenue of over

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DALL. MORNING NEWS, July 26, 2001, at 1C.

2. *See generally* Jerry A. Hausman, *Taxes and Labor Supply*, *in* 1 HANDBOOK OF PUBLIC ECONOMICS 213 (Alan J. Auerbach & Martin Feldstein eds., 1985).

3. Ms. Evangelista made the comment in 1990, when the combined marginal federal, New York state, New York City, and payroll tax rate was in excess of 45%, assuming an individual filer in the maximum tax bracket. E.J. McMahon, *Pricing the "Luxury Product": New York City Taxes Under Mayor Bloomberg*, 47 CIV. REP., Nov. 2005, at fig.3; *History of Federal Individual Income Bottom and Top Bracket Rates*, NAT'L TAXPAYERS UNION, http://www.ntu.org/tax-basics/history-of-federal-individual-1.html (last visited Dec. 23, 2011); N.Y. ST. DEP'T OF TAX'N & FIN., 1990 NEW YORK STATE TAX TABLE FOR FORMS IT-200, IT-201 AND IT-203 (1990).

4. Unlike geese, baboons, lions, fish, dogs, whales, ships, and trucks, no collective noun has yet emerged to describe a group of billionaires. THE NEW OXFORD AMERICAN DICTIONARY (2001). Perhaps, a "bevy of billionaires." Professor Len Burman suggests a "flush of billionaires." Email from Len Burman, Professor, Syracuse University, to Eric M. Zolt (Feb. 23, 2011) (on file with the Author).

5. A list of individuals who have taken the Giving Pledge can be found at http://givingpledge.org/ (last visited Dec. 23, 2011). Appendix A, *infra*, provides a current list of the individuals who pledged and an estimate of their current wealth.

6. For those donors who realize no income tax benefits from charitable contributions, the tax subsidy is 35% (the relief from gift and estate tax liability). For donors with substantial income tax liability, the tax subsidy rate could be over 70%. This estimated tax benefit assumes a federal income tax rate of 35%, a state income tax rate of 6%, a capital gains rate of 15%, and a federal estate tax rate of 35%. It also assumes that the donation is funded with appreciated stock with a basis equal to 10% of the fair market value at the date of contribution. If the charitable gift were made in cash or stock held until death (thus, not subject to capital gains tax), the subsidy rate is 60%. Both of these examples also assume that the limits on annual charitable deductions (50% of adjusted gross income for cash and 30% of adjusted gross income for appreciated stock or, in the case of donations to private foundations, 30% of adjusted gross income for cash and 20% of adjusted gross income for appreciated stock) are not applicable.

For many billionaires, the tax savings from charitable contributions will be a smaller percentage of the amounts contributed because their effective state and federal income tax rates are well below the maximum statutory rate. IRS data for 2008 for the 400 households with the highest gross income shows that the effective tax rate for this group (which may or may not reflect those individuals subject to the pledge) was 18.1% of gross income, as over half of the gains for taxpayers in this group were from capital gains and dividends that are subject to a maximum tax rate of 15%. IRS, THE 400 INDIVIDUAL INCOME TAX RETURNS REPORTING THE HIGHEST ADJUSTED GROSS INCOMES EACH YEAR, 1992–2008, at 10 (2011).

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$110 billion.[7] So, one way of looking at the pledge is that these billionaires are not just being generous with their money, but with the money of the American people.

Americans, even those who are not billionaires, are generous. We donate more money (and often highly appreciated property) to fund charitable activities, both in the U.S. and abroad, than taxpayers in any other country.[8] Charities fulfill many important functions in our society, and in many cases relieve the government of the responsibility of addressing important social, economic, and cultural functions. Tax benefits, particularly the charitable tax deduction for individuals and corporations, play an important role in the success and viability of the nonprofit sector. No doubt, donors are more generous than they would be in a world without tax subsidies, perhaps even by an amount greater than the lost tax revenue.[9]

It is curious, though, that despite the long lineage of the charitable deduction, we lack a comprehensive, coherent theory that explains successfully why governments should allow tax deductions to subsidize the current collection of qualified charitable activities and charitable organizations.[10] It is not from lack of trying.[11] Early tax theories were donor-focused, positing that income transferred for charitable purposes was not personal consumption and, as it was no longer in the control of the donor, should be excluded from tax.[12] Other theories claim that the charitable tax deduction helps correct market or political failures in our society.[13] Thus, tax benefits help increase the amount of collective goods or services that are otherwise underprovided because of free-rider and other challenges.[14] The charitable tax deduction also helps decentralize the spending process by allowing the minority to overcome the preferences of the majority or the vagaries of the political process in spending tax dollars, merely by contributing some of their own money to projects that they deem worthy of broader support.[15] But even if one

7. The $110 billion is a very rough estimate arrived at by looking at an estimate of the total wealth of individuals signing the pledge (roughly $330 billion), an assumed level of donations of two-thirds of wealth, and an assumed income, gift, and estate tax benefit of 50%.

8. *See* CHARITIES AID FOUNDATION, INTERNATIONAL COMPARISONS OF CHARITABLE GIVING 2 (2006).

9. Gerald E. Auten et al., *The Effect of Tax Reform on Charitable Contributions*, 45 NAT'L TAX J. 267, 288 (1992); David Joulfaian, *Estate Taxes and Charitable Bequests by the Wealthy*, 53 NAT'L TAX J. 746, 761–62 (2000).

10. David E. Pozen, *Remapping the Charitable Deduction*, 39 CONN. L. REV. 531, 547 (2006).

11. *See infra* Part II.B.

12. *See infra* notes 95–99 and accompanying text.

13. *See infra* Part II.B.2.

14. Mark P. Gergen, *The Case for a Charitable Contributions Deduction*, 74 VA. L. REV. 1393 (1988).

15. Burton A. Weisbrod, *Toward a Theory of the Voluntary Nonprofit Sector in a Three-Sector Economy*, *in* THE ECONOMICS OF NONPROFIT INSTITUTIONS: STUDIES IN STRUCTURE AND POLICY 21, 23 (Susan Rose-Ackerman ed., 1986); *see also* Saul Levmore, *Taxes as Ballots*, 65 U. CHI. L. REV. 387, 402 (1998).

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were convinced that the charitable deduction was intended to address the problems identified by these theories, it is not clear that the charitable deduction in its current form is the best way of addressing these failures.

There are real gains from using the tax system to subsidize charitable activities. Supporters note both the diversity and the higher quality of charitable goods and services that come from programs funded by individuals who devote money, and often time and expertise, in selecting, managing, and monitoring activities that often benefit society at large, rather than those programs selected by some Washington bureaucrat and managed and monitored by government employees.[16]

But these also are costs. The cost in terms of forgone revenue from federal tax benefits to individuals and corporations for contributing to charitable activities is substantial: an estimated $37 billion for 2010 and an estimated $246 billion for fiscal years 2010–2014.[17] The tax cost of exempting qualifying activities of tax-exempt organizations from income tax is not included in the list of tax expenditures, but may be about $10 billion a year.[18] There are also costs associated with charities behaving badly.[19] The IRS approves virtually all applications for tax-exempt status,[20] and state attorneys general lack the resources or interest to monitor the activities of charitable operations within their jurisdictions. Thus there is little monitoring to ensure charities are actually being charitable. There also may be substantial opportunity costs, as federal funds used to support charitable activities chosen by donors perhaps could have been better spent on other government programs or on charitable activities selected by a different process. Finally, there are costs related to allowing a minority to dictate how federal funds are spent. For just about any activity or cause for which a charitable organization exists, there are supporters and detractors—whether it is funding for opera, different religions and religious activity, or questions involving controversial subjects like funding for Planned Parenthood, the Westboro Baptist Church, or USC football.[21]

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16. Harold M. Hochman & James D. Rodgers, *The Optimal Tax Treatment of Charitable Contributions*, *in* ECONOMICS OF NONPROFIT INSTITUTIONS, *supra* note 15, at 224, 238 (noting that wealthy donors are more likely to donate expertise in addition to money, as opposed to less well-off charitable individuals).

17. STAFF OF J. COMM. ON TAX'N, 111TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2010–2014, at 43–48 (Comm. Print 2010).

18. Evelyn Brody & Joseph J. Cordes, *Tax Treatment of Nonprofit Organizations: A Two-Edged Sword?*, *in* NONPROFIT & GOVERNMENT: COLLABORATION & CONFLICT 141, 148–49 (Elizabeth T. Boris & C. Eugene Steurle eds., 2d ed. 2006); *see also* Harvey P. Dale, *Foreign Charities*, 48 TAX LAW. 655, 658–59 (1995).

19. Roger Colinvaux, *Charity in the 21st Century: Trending Towards Decay*, 11 FLA. TAX REV. 1, 19 (2011).

20. IRS, PUB. 55B, DATA BOOK, 2008, at 55 (2009).

21. Internal Revenue Code section 170(l) allows donors to deduct 80% of contributions made to universities (often limited by the university to contributions made to athletic programs) to secure elite

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Should we allow tax benefits to subsidize charitable activities? One approach is simply to ask whether we are better off with the current tax regime than we would be without it: the "take or leave it" approach. Donors do a lot of good things that local or federal governments would or could not do, and it may be worth the potential financial and other costs to obtain these good works. While we lack a single theory that marries tax subsidies to the current collection of qualified charitable activities and charitable organizations, the existing tax regime offers a well-accepted set of trade-offs that results in diversity, pluralism, and even cacophony that are important in our society.[22] In a world of imperfect information and political economy challenges, providing matching federal funds through the charitable deduction may be the best approach to increase the level of underprovided goods and services in a liberal, democratic society, such as ours.

Alternatively, one can imagine a "bang for the buck" approach, designing government assistance for charitable activities in a way that maximizes the return for amount of government funds expended. This could include measures such as narrowing the definition of qualified charitable activities to claim deductions for contributions, matching deductions for specific activities rather than entities, converting the charitable deduction into a credit, or adopting targeted grants or credits to support specific charitable activities.

A few years ago, this was just an academic (in the pejorative sense of the word) question. But in just five years, the charitable tax deduction has gone from politically untouchable[23] to potential collateral (or not so collateral) damage in the name of fundamental tax reform. In his 2010 budget, President Barack Obama proposed limiting the tax benefits for high-income taxpayers for personal deductions, including the charitable deduction, as a revenue-raising proposal.[24] Two recent reform proposals go further and seek to repeal many personal deductions, replacing the charitable tax deduction with a credit, as a means to dramatically increase the tax base so that tax rates can be reduced.[25] Additionally, the

status that allows them preferential tickets to athletic events. I.R.C. § 170(l) (2010).

22. Harvey P. Dale, Commentary on Eric M. Zolt, Tax Deductions for Charitable Contributions: Domestic Activities, Foreign Activities, or None of the Above, Presentation at the NYU School of Law Colloquium on Tax Policy and Public Finance (Mar. 10, 2011) (on file with the Author).

23. President George W. Bush charged his 2005 tax reform advisory panel to recognize "the importance of homeownership and charity in American society," a not-so-subtle recommendation to preserve tax benefits for mortgage interest and charitable deductions. PRESIDENT'S ADVISORY PANEL ON FEDERAL TAX REFORM, SIMPLE, FAIR, AND PRO-GROWTH: PROPOSALS TO FIX AMERICA'S TAX SYSTEM 41 (2005).

24. The Obama budget proposal would allow donors to deduct an amount equal to 28% of their contributions, even if their marginal tax rate exceeded 28%. OFF. OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, A NEW ERA OF RESPONSIBILITY: RENEWING AMERICA'S PROMISE 29 (2009).

25. *See* DEBT REDUCTION TASK FORCE, RESTORING AMERICA'S FUTURE: REVIVING THE ECONOMY, CUTTING SPENDING AND DEBT, AND CREATING A SIMPLE, PRO-GROWTH TAX SYSTEM 33 (2010) (proposing

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Congressional Budget Office has recently evaluated eleven proposals for changing the tax incentives of charitable giving.[26]

This Article seeks to contribute to the debate on the desirability of the charitable tax deduction by focusing on a smaller part of the charitable tax world—charitable deductions for foreign assistance. Charitable tax benefits for foreign assistance raise many of the same key issues that arise in the purely domestic context, such as the relative worthiness of competing charitable projects, the mandatory participation by the indirect taxpayer-donors in projects favored by those who are willing to contribute their own funds, questions of monitoring and enforcement, and the use of for-profit entities to achieve charitable purposes.

Tax benefits for foreign assistance also raise several issues that may be less important or absent in subsidizing domestic activities. For example, if part of the rationale for tax benefits for charitable activity rests on the underprovision of certain collective goods or services in a society, using funds from Country A to support activities in Country B may be problematic. In addition, using tax subsidies for foreign assistance may support activities that are at odds with U.S. government policies in a particular country or region. Finally, the existing theories of charitable contributions assume a simple three-sector model with government, a private sector, and a nonprofit sector that are part of a single society in which voting, contributions, and subsidies takes place.[27] Cross-border charitable assistance involves more actors (multilateral institutions, bilateral donors, foreign governments, and foreign charities) and more preferences (recipient country and its citizens) than domestic charitable activity.

The following examples may be useful in thinking about the issues raised in this Article:

- Should we allow tax benefits to subsidize contributions made to domestic charities to support assistance to victims of Hurricane Katrina? (domestic charities with domestic activities)
- Should we allow tax benefits to subsidize contributions made to domestic charities to support assistance to victims of the Japanese earthquake and tsunami? (domestic charities with foreign activities)

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to replace the existing charitable deduction with a 15% refundable credit that would be paid to the qualifying charity rather than to the donor-taxpayer); NAT'L COMM. ON FISC. RESP. & REF., CO-CHAIRS' PROPOSAL 22–27 (2010) (proposing to replace the existing charitable deduction with a 12% credit for charitable contributions in excess of 2% of the taxpayer's adjusted gross income; for those billionaires with low marginal tax rates and relatively low adjusted gross income, the credit may yield greater tax saving than the existing charitable-deduction regime).

26. CONG. BUDGET OFF., PUB. NO. 4030, OPTIONS FOR CHANGING THE TAX TREATMENT OF CHARITABLE GIVING 9–19 (May 2011).

27. *See, e.g.*, Weisbrod, *supra* note 15.

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- Should we allow tax benefits to subsidize contributions made to Japanese charities to support assistance to victims of the Japanese earthquake and tsunami? (foreign charities with foreign activities)
- Should we allow tax benefits to subsidize contributions made to for-profit entities engaged in charitable activities? (for-profit charities, regardless of the domesticity of their organization or activities)

These are important questions. But current charitable, economic, and legal scholarship provide relatively little guidance in determining whether to allow charitable deductions to support charitable activities outside the U.S., to support foreign charities, and to support for-profit entities that engage in charitable activities. And perhaps the failure of the current scholarship to lead us to answers on foreign charitable activities should lead us to question the regime it supports domestically.

Congress adopted much of the current tax regime covering qualifications for tax-exempt status and the deductibility of charitable contributions when most U.S. taxpayers were focusing little attention on foreign charitable activities. It is time to examine the current tax regime that applies to foreign charitable assistance and whether, or how, it should be changed, by focusing on three key questions: (1) Should tax benefits support charitable activities outside the U.S.? (2) Should the tax system treat foreign charities differently from domestic charities? (3) Should the tax system extend charitable tax benefits to for-profit entities engaged in charitable activities, including activities outside the U.S.?

The extension of the charitable deduction to foreign activities or for-profit charities, then, becomes an incremental decision: We have a deduction for domestic charitable activities, so why not for foreign charitable activities or for-profit entities engaged in charitable activities? But to answer that question, we must know whether foreign charitable activities and for-profit charities are sufficiently similar to domestic charitable activities in the characteristics that warrant the charitable deduction. So, we must know why we have a domestic charitable deduction.

Here is the rub. The existing scholarship does not offer a coherent theory for the domestic charitable deduction, and certainly not one robust enough to cover the current collection of qualified charitable activities and charitable organizations, either normatively or descriptively. Perhaps attempting to solve the question of whether to extend the domestic charitable deduction to foreign activities (or for-profit charities) provides us with the chance to evaluate the strengths and weaknesses of our current policy approach and to consider alternatives. Starting with a clean slate, strong arguments can be made that the best way for the U.S. government to help achieve social goals in foreign

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countries is not by offering to match amounts contributed to causes selected by donors. Similarly, it may be that the best way to engage for-profit entities in charitable activities is not by granting them tax-exempt status or allowing supporters of these entities to deduct amounts contributed to fund these activities. This exercise—the design of the mechanisms to achieve social goals outside the U.S. and to engage for-profit entities both in the U.S. and abroad—may provide useful insights about whether we should keep our current tax regime for domestic charitable deductions or consider other alternatives.

Recent scholarship has argued for continuing to allow tax benefits to overseas charitable activities,[28] and for extending charitable tax benefits to foreign charities[29] and for-profit charities.[30] These arguments rest partly on the idea that favorable tax treatment should follow because there is no meaningful way to distinguish these activities or entities from domestic charities engaged in domestic charitable activities.[31] While these scholars may be right in arguing for consistent tax treatment for contributions made to support domestic and foreign charitable activities, they may be wrong in supporting the charitable deduction as that choice of tax treatment. Perhaps the best approach is to consider changes to the current charitable-deduction regime for all charitable activities and to consider other alternatives for government support and incentives for charitable activities.

In Part I, this Article undertakes a brief review of the charitable tax landscape and the consequences of using the tax system as a vehicle for supporting many types of charitable activities. Part II examines whether tax benefits should support charitable activities outside the U.S. Part III reviews whether the tax law should treat foreign charities differently from domestic charities. Part IV examines whether tax benefits should be extended to for-profit entities that engage in charitable activities. The Conclusion looks at the implications for the domestic charitable deduction raised by these problems.

I. The Charitable Tax Landscape

At a general level, there are two major types of tax benefits accorded entities engaged in charitable activity. First, the tax law provides an exemption from income tax for organizations that are organized and operated for certain qualifying purposes and that are subject to a "nondistribution constraint," whereby earnings cannot

28. Pozen, *supra* note 10, at 600–01.

29. *See, e.g.*, Dale, *supra* note 18, at 696.

30. Anup Malani & Eric A. Posner, *The Case for For-Profit Charities*, 93 Va. L. Rev. 2017, 2042–45 (2007).

31. *See, e.g.*, *id.* at 2029–56; Pozen, *supra* note 10, at 588-94.

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benefit any private shareholder or individual.[32] Second, the tax law allows individuals and corporations to claim tax deductions for charitable contributions made to qualified organizations.[33] Individuals can deduct the value of the contributions against income, gift, and estate taxes.[34] Additional tax benefits apply to gifts of appreciated property, as taxpayers can generally avoid the capital gains tax on donated property while deducting the fair market value from a portion of their taxable income.[35]

In thinking about tax deductions for charitable activities both within and outside the U.S., it may be useful to start with this exercise: Imagine there are $50 billion in government funds available each year to support charitable activities. How should those funds be allocated? Ideally, from a utilitarian standpoint, the funds would be used to encourage those activities with the greatest social returns.[36] The gains from the charitable activities would reflect both the worthiness of purpose and the efficiency of performance.[37] This "comparable worthiness" approach would rank competing projects and fund those activities and organizations that have the greatest potential gains.[38]

The framework below sets forth different combinations of funding and allocation decisions that reflect the public and private nature of using tax deductions to subsidize charitable activities.[39]

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32. Several different types of organizations qualify for tax-exempt status under section 501 of the Internal Revenue Code. Section 501(c)(3) provides for eight categories of organizations that qualify for tax-exempt status. *See generally* Richard Schmalbeck, *Reforming Uneven Subsidies in the Charitable Sector*, 66 EXEMPT ORG. TAX REV. 237 (2010). Most entities qualify for tax exemption by being organized and operated for religious, charitable, or educational purposes. Other qualifying activities include entities organized for scientific, public-safety testing, or literary purposes, and organizations intended to foster national, or international amateur sports competition, or for the prevention of cruelty to children or animals. There are also prohibitions on political campaign activity and excessive lobbying. I.R.C. § 501(c)(3) (2010).

33. I.R.C. § 170(c)(1) (2010).

34. *See* BRUCE R. HOPKINS, THE LAW OF TAX-EXEMPT ORGANIZATIONS 32–35 (10th ed. 2011); *see also* I.R.C. §§ 170(a), 2055(a)(2), 2522(a) (2010).

35. Daniel Halperin, *A Charitable Contribution of Appreciated Property and the Realization of Built-In Gains*, 56 TAX L. REV. 1, 10 (2002). In addition to these two types of tax benefits, tax-exempt entities may also have access to tax-exempt financing, which can substantially reduce the cost of borrowing. Tax-exempt entities also may qualify for state and local income tax, sales tax, and property tax benefits. *See generally* Brody & Cordes, *supra* note 18.

36. Schmalbeck, *supra* note 32, at 237.

37. *Id.* at 245–47.

38. It would be very difficult to implement this approach as it would require some consensus for determining the relative worthiness of different charitable activities and for determining and measuring the effectiveness of performance. *Id.* at 250–51.

39. This framework was suggested by Mitchell Kane in his Commentary on Eric M. Zolt, Tax Aspects of Private Development Assistance, Presentation at NYU School of Law Rubin International Law Symposium (Dec. 4, 2009), *available* at http://iilj.org/research/documents/Zolt.ppt.

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TABLE 1: COMBINATIONS OF FUNDING AND ALLOCATION DECISIONS

		Funding Alternatives	
		Private Funds	*Public Funds*
Allocation Alternatives	*Private Actors*	Unmatched portion of charitable contributions	Matching portion of charitable contributions
	Public Actors	Government regulation (incentives and restrictions on the use of private funds)	Direct government programs (such as official development assistance to foreign countries)

The upper left box reflects the use by individuals or corporations of their own funds to support activities they choose. This is the after-tax cost of charitable contributions (so if an individual is in the 35% marginal tax bracket and makes a $1,000 contribution, the value of the tax deduction is $350 and the after-tax cost would be $650). For those individuals who receive no tax benefits for their contributions, either because they do not itemize deductions or have no tax liability, the full amount of their contribution would be included in this box.

The upper right box reflects the tax benefits associated with the contribution. Here private actors determine how public funds are allocated. Who needs Senators Barbara Boxer or Dianne Feinstein? I can get my own private earmark to support medical services to combat cholera in Haiti simply by writing a check to the U.S. affiliate of Doctors Without Borders (Médécins Sans Frontières).

The bottom left box reflects government regulation that influences the use of private funds for charitable purposes. This includes both incentives for funding certain types of activities and organizations and disincentives and prohibitions against certain types of activities, such as expenditures that may jeopardize an organization's tax-exempt status or that may result in excise taxes for private foundations.[40]

Finally, the bottom right box reflects public actors spending public funds. This could be Congress deciding directly how funds from general tax revenues should be spent or delegating spending decisions to specific government agencies, such as the Department of State, or to some band of experts, such as the governing boards of the National Science Foundation or the National Endowment of the Arts. The key insight is that the decision to provide federal funds for charitable activities can be separated from the decision of who gets to decide how federal funds are spent.

40. *See* I.R.C. § 4945 (2010); *Private Foundations—Taxable Expenditures (Sec. 4945)*, Tax Mgmt. Portfolio (BNA) No. 474 (2008).

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But the charitable deduction is not just about funding worthwhile projects. The $50 billion of government funds could be used to create incentives for private actors to contribute not just their money, but their ideas, their expertise, and their ability to monitor activities. These behavioral effects lead to targeting incentives to increase the level of marginal giving and participation.[41] Perhaps this justifies using the tax system to target matching grants to the rich (high-bracket taxpayers) rather than the middle class or the poor.[42]

Viewing the charitable deduction as a matching grant program sponsored by the federal government highlights some of the undesirable aspects of the current tax regime.[43] Because the matching grant program is run through the federal income tax system, only some donations get matched and how much gets matched depends on the contributor's income tax rate.[44] Most notably, only those who itemize deductions for tax purposes have their charitable deductions matched by the federal government.[45] This often means that upper-middle-income and high-income taxpayers get tax benefits from charitable contributions, but middle-income and low-income taxpayers do not. Individuals can dictate how some of the roughly $50 billion in annual federal matching funds are spent, but they must contribute their own funds and itemize their deductions to get a say in the allocation.

The current tax system sets the marginal reimbursement rate for charitable contributions (the subsidy amounts) equal to the donor's marginal tax rate. But there is no theoretical reason why this is a desirable result.[46] The optimal marginal reimbursement rate depends on several factors, such as responsiveness to tax incentives, "voice" in allocating federal funds for charitable purposes, and incentives in recruiting donors to select, fund, and monitor charitable projects. The choice of optimal marginal tax rates reflects a very different set of considerations.

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41. David M. Schizer, *Subsidizing Charitable Contributions: Incentives, Information and the Private Pursuit of Public Goals*, 62 TAX L. REV. 221, 235–39 (2009).

42. *Id.*

43. One could keep the amount of federal funding for charitable activities constant but design a matching grant program that avoids several of the deficiencies of the current charitable tax deduction. *See* Paul R. McDaniel, *Federal Matching Grants for Charitable Contributions: A Substitute for the Income Tax Deduction*, 27 TAX L. REV. 377, 413–14 (1971).

44. Charles T. Clotfelter & Lester M. Salamon, *The Impact of the 1981 Tax Act on Individual Charitable Giving*, *in* ECONOMICS OF NONPROFIT INSTITUTIONS, *supra* note 15, at 207, 209.

45. Generally, only about 30% of taxpayers itemize their deductions. *See generally* Deena Ackerman & Gerald Auten, *Floors, Ceilings, and Opening the Door for a Non-Itemizer Deduction*, 59 NAT'L TAX J. 509 (2006). In 2008, 33.8% of individual U.S. tax returns claimed itemized deductions. IRS, PUB. 4198, 2010 TAX STATISTICS: STATISTICS OF INCOME (2010).

46. Daniel Shaviro, Commentary on Eric M. Zolt, Tax Deductions for Charitable Contributions, Presentation at the NYU School of Law Colloquium on Tax Policy and Public Finance (Mar. 10, 2011) (on file with the Author).

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For those who value large scale charitable projects by wealthy individuals, the current system likely provides inadequate tax incentives for charitable contributions. Many of the billionaires who signed the Giving Pledge likely have relatively low marginal income tax rates (but gift and estate tax rates of 35%).[47] Most of their wealth is in the form of unrealized capital appreciation and most of their income is tax favored, either in the form of tax-exempt interest or dividends, capital gains, and "carried interest" in investment partnerships, each of which is subject to a 15% tax rate.[48] If we really wanted to encourage the very wealthy to be more charitable (particularly the young billionaires), it makes sense to increase the charitable subsidy by increasing the marginal reimbursement rate, and not tie the subsidy to their tax rate. In contrast, for those who are concerned that high-income taxpayers already have greater voice in allocating federal funds for their favored charities (charities engaged in educational, cultural, and medical activities) rather than charities favored by lower-income individuals (religious institutions and social welfare agencies), the marginal reimbursement rate would be the same for all donors, regardless of tax rate.[49]

One could keep the total amount of federal funding for charitable activities at the same $50 billion amount, but design a matching grant program that has different allocation and matching criteria from the current system. For example, if Congress determines that $200 million of federal funds should be allocated to match private contributions made to museums, then museums could apply for matching funds based on criteria besides idiosyncratic donor preferences.[50]

A common refrain among tax scholars is that the tax deduction for charitable contributions has an "upside-down" effect.[51] High-bracket taxpayers receive greater tax benefits than low-bracket taxpayers; and those taxpayers who do not itemize their deductions receive no tax benefit at all.[52] Of the estimated $35 billion in tax benefits related to charitable deductions in 2009, over $19.1 billion went to taxpayers with $200,000 or more in income and $9.1 billon went to taxpayers with incomes of $100,000 to $200,000.[53] Concern with this upside-down effect

47. *See* IRS, *supra* note 6, at 11.

48. *Id.* at 3.

49. See Appendix B, *infra*, for information on charitable giving by households, income levels, and type of charity.

50. This approach has the advantage of being more transparent as to the level of funding for the activity and the identity of the beneficiaries of federal funds. Depending on the requirements to be eligible for matching funds, it may also reduce funds spent on nonqualifying activities. At the same time, this approach also has several disadvantages, including higher administrative costs and the potential risk of corruption and similar challenges that come with having government officials involved in allocating funds.

51. *See, e.g.*, McDaniel, *supra* note 43, at 383–84.

52. Justin Bryan, *Individual Income Tax Returns*, STAT. INCOME BULL., Fall 2009, at 7–14.

53. STAFF OF J. COMM. ON TAX'N, *supra* note 16, at 56. A more detailed analysis is presented in

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has led to proposals to replace the charitable deduction with a refundable credit.[54]

While the charitable deduction certainly provides greater financial incentives for those in higher tax brackets, my own take is slightly different and highlights the tax burden of high-bracket non-donors. At a general level, the tax cost of charitable deductions can be viewed as either reducing government spending or increasing taxes; so either government programs are smaller for tax year 2010 by the $37 billion that subsidized taxpayer contribution to charity, or taxes on other taxpayers are higher by $37 billion (or some combination). As a group, the top 10% of taxpayers pay about 70% of total federal income taxes, and the top 50% of taxpayers pay all or mostly all of federal income taxes.[55] So who bears the costs of subsidizing charity? If one takes the view that tax rates are higher because of the charitable deduction, then the cost of this subsidy is borne by less charitable high-income taxpayers. Thus, the poor are not disproportionately subsidizing the Bill and Melinda Gates Foundation's activities or the Los Angeles Opera's $32 million post-modern production of Richard Wagner's Ring Cycle; it is the high-bracket taxpayers who are not charitably inclined who bear the major burden of these endeavors.[56]

With the benefits of leveraging government funds to increase the money and expertise contributed by private actors to charitable activities comes the responsibility of ensuring that the private and matching government funds are actually used for charitable purposes. For practical purposes, the bar for qualifying for charitable status for both tax and state law purposes is remarkably low. The IRS and state governments share oversight of the nonprofit sector. The IRS has the authority to grant the initial qualification for tax-exempt status, while nonprofit status

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Appendix B, *infra*, using data from CENTER ON PHILANTHROPY AT IND. U., PATTERNS OF HOUSEHOLD CHARITABLE GIVING BY INCOME GROUP, 2005, at 12 (2007).

54. *See* WILLIAM VICKREY, AGENDA FOR PROGRESSIVE TAXATION 131 (1947); Lily L. Batchelder et al., *Efficiency and Tax Incentives: The Case for Refundable Tax Credits*, 59 STAN. L. REV. 23, 52–53 (2006); Brian H. Jenn, *The Case for Tax Credits*, 61 TAX LAW. 549, 555–57 (2007). The choice between a credit and a deduction for charitable contributions depends on both equity and efficiency considerations, as well as on one's view of the purpose of the charitable deduction. If the purpose is to correct failures in the political process, the credit approach has great appeal as the deduction both disenfranchises lower-income individuals and gives higher-income individuals disproportionate power over the direction of federal funds. If the purpose is to correct market failures in underprovided public goods, a deduction approach may yield more "bang for the buck," assuming high-income donors are more responsive to tax incentives than are low-income donors.

55. The Tax Policy Center estimates that 46% of American households will owe no income tax in 2011. RACHEL JOHNSON ET AL., TAX POL'Y CENTER, WHY SOME TAX UNITS PAY NO INCOME TAX 1 (July 2011).

56. This may be another factor in why the current tax regime for charitable contributions is part of a political bargain that is acceptable to low-income and middle-income groups. *See* Jeff Strand, *The Charitable Deduction: A Politico-Economic Analysis*, *in* ECONOMICS OF NONPROFIT INSTITUTIONS, *supra* note 15, at 265–68.

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is determined under state corporate law.[57] The IRS receives more than 50,000 applications for tax-exempt status each year and approves virtually all of them.[58] As long as the organization complies with the rules against private inurement, private benefit, and political activity, the IRS will generally grant tax-exempt status to any organization that has a plausible charitable purpose, broadly defined.[59]

There are mandatory disclosure requirements for charities with annual gross receipts over $25,000.[60] The IRS has revised the tax return form applicable to tax-exempt organizations (Form 990) to include more questions related to governance and has published best-practice governance guidelines.[61] While the IRS has the authority to terminate tax-exempt status for violating the prohibitions against private benefits[62] or certain public policy provisions,[63] the IRS has few sanctions for less serious violations.[64]

In response to some abuses concerning charities controlled by a small group of donors, Congress has imposed additional limitations for those charities where donors and control are highly concentrated, known as private foundations. The tax law provides for several excise taxes that apply to self-dealing and other transactions between insiders and the private foundation.[65] Private foundations are also required to make "qualifying distributions" to charitable activities each year equal to 5% of their net assets.[66] Private foundations cannot treat grants to foreign

57. Jill R. Horwitz, *Does Nonprofit Ownership Matter?*, 24 YALE J. ON REG. 139, 146–47 (2007).

58. In 2008, the IRS approved about 98% of all applications. ROB REICH, LACEY DORN & STEFANIE SUTTON, STAN. U. CTR. ON PHILANTHROPY & CIV. SOC'Y, ANYTHING GOES: APPROVAL OF NONPROFIT STATUS BY THE I.R.S. 7–11 (2009).

59. Reich, Dorn, and Sutton have demonstrated how little the IRS exercises any substantive oversight by listing the twenty most eccentric public charities approved by the IRS in 2008. *Id.* at 17–24. These organizations include the All Colorado Beer Festival, Curtains Without Borders, the International Society of Talking Clock Collectors, and the Gateway Sisters of Perpetual Indulgences (nuns from the leather community). *Id.*

60. Organizations with annual gross receipts of less than $25,000 ($50,000 for tax years ending on or after December 31, 2010) are required to file Form-990-N, also known as the e-postcard. This form requires only very basic information about the charitable organization.

61. *See generally* Tax Analysts, *IRS Releases Final 2008 Form 990 for Tax-Exempt Organizations*, 2007 TAX NOTES TODAY 246-16.

62. I.R.C. §§ 501(c)(3), 7805(b)(8) (2010); Treas. Reg. §§ 1.501(c)(3)-(c)(2), 301.7805-1(b) (2010).

63. *See, e.g.*, Bob Jones Univ. v. United States, 461 U.S. 574, 579 (1983) (upholding the IRS's revocation of tax-exempt status for violating the established public policy of discouraging discrimination in education).

64. Lloyd Hitoshi Mayer & Brendan M. Wilson, *Regulating Philanthropy in the 21st Century: An Institutional Choice Analysis*, 85 CHI.-KENT L. REV. 479, 526 (2009).

65. The IRS regulates private foundations through a series of excise tax provisions set forth in sections 4940–4946. These include taxes on failure to satisfy minimum distribution obligations, sanctions on excess business holdings, sanctions on jeopardizing investments, and sanctions on "taxable expenditures" (grants where private foundations fail to exercise expenditure responsibility or fail to make a good faith determination that the recipient organization is equivalent to a section 509(a)(1), (2), or (3) organization).

66. I.R.C. § 4942(g) (2010).

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charities as part of the qualifying distributions unless they can establish that the foreign grantee has either obtained an exemption ruling from the IRS or the private foundation has made a good faith determination that the foreign grantee is equivalent to a U.S. public charity.[67] Private foundations are also subject to excise taxes for certain "taxable expenditures," which include amounts contributed to foreign grantees unless either the private foundation can establish that the recipient is equivalent to a public charity or that it exercises expenditure responsibility.[68]

Finally, nonprofits are also subject to state government regulation. Qualifying under state nonprofit law is generally even easier than gaining federal tax-exempt status.[69] In most states, founders simply file a certificate of incorporation and a copy of the bylaws with the state agency and pay a de minimis fee.[70] Although the state attorney general has oversight of the activities of charitable organizations organized and operated in the state, the general consensus is that there has been inadequate state supervision of charitable activities, particularly with regard to enforcing the fiduciary duties of officers, directors, and trustees.[71] Dissatisfaction with governance of nonprofits has led to various proposals for greater federal or state oversight.[72] These proposals include a new federal oversight agency or new state-level agencies or commissions.[73] In addition, there are proposals for additional monitoring by the private sector through either a private regulatory body with oversight of certain charities or increased opportunities for individuals to bring suits challenging improper activities of officers and directors of nonprofit organizations.[74]

67. *See* Kimberly S. Blanchard, *U.S. Taxation of Foreign Charities*, 8 EXEMPT ORG. TAX REV. 719, 723 (1993).

68. I.R.C. § 4945(d) (2010). Expenditure responsibility requires (1) a pre-grant inquiry that the grantee will make reasonable use of funds; (2) a written agreement between the grantor and grantee; (3) that the grantee will keep funds in a separate account; (4) that the grantee will report in writing one year after the grant how the funds were used; and (5) that the grantor will report to the IRS how the funds were used. JOHN A. EDIE, EXPENDITURE RESPONSIBILITY: STEP BY STEP 9 (2002).

69. Horwitz, *supra* note 57, at 147.

70. *Id.*

71. Kenneth L. Karst, *The Efficiency of the Charitable Dollar: An Unfulfilled State Responsibility*, 73 HARV. L. REV. 433, 434–37 (1960).

72. *See* Mayer & Wilson, *supra* note 64, at 501–04.

73. *Id.* at 495–501. Commentators have also called for stronger internal controls for nonprofits. *See* Christine Petrovits et al., *The Causes and Consequences of Internal Control Problems in Nonprofit Organizations*, 86 ACCT. REV. 325, 329 (2011).

74. *See* Mayer & Wilson, *supra* note 64, at 501–04; *see also* Karst, *supra* note 71, at 445–49.

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II. Should Tax Benefits Support Charitable Activities Outside the United States?

With some exceptions and restrictions, current law allows individuals and corporations to deduct contributions made to U.S. charities, even if most or all of the funds are used to support foreign charitable activities.[75] Should tax law privilege domestic charitable activities over foreign charitable activities?

A. General Considerations

To some readers, this may appear to be a relatively easy question: we should allow tax subsidies for charitable activities outside the U.S. We are rich; they are poor.[76] For a wealthy country, there is a moral obligation to provide financial and other support for famine and poverty relief.[77] And even from a purely selfish perspective, the negative externalities attributable to environmental pollutants, infectious diseases, and destructive ideologies would support subsidizing charitable activities outside the U.S. to minimize domestic consequences.[78]

Over the last twenty years, there has been a substantial shift from official development assistance by governments and international institutions to private philanthropy and remittances.[79] Foreign charitable assistance has increased dramatically both from U.S. entities with foreign charitable activities and from the growth of the charitable sector in both developed and developing countries.[80] Domestic private foundations and public charities can generally use funds received from U.S. donors to support foreign charitable activities, but individuals generally cannot receive tax deductions for contributions made directly to foreign charities.[81] Although tax benefits for foreign charitable activities supported by U.S. taxpayers are still limited, in 2007 U.S. entities provided about $40 billion for foreign charitable activities, while U.S. governmental assistance (aside from tax benefits) totaled only $21.8 billion.[82] If the relatively thin popular support for the U.S. government's

75. *See* Pozen, *supra* note 10, at 540–42; *see also* Dale, *supra* note 18, at 659–62.

76. About half of the world's population (about 3 billion people) lives on less than $2.50 a day. The mortality rate for children under five is fifteen times higher in low-income countries than in high-income countries. UNICEF, LEVELS & TRENDS IN CHILD MORTALITY 18 (2011).

77. Moral philosophers, such as Peter Singer, make a compelling case for the "cosmopolitan" responsibilities of those in affluent countries to help those in countries with extreme poverty. *See generally* PETER SINGER, THE LIFE YOU CAN SAVE: ACTING NOW TO END WORLD POVERTY (2009).

78. Pozen, *supra* note 10, at 580.

79. *See* Heidi Metcalf Little, *The Role of Private Assistance in International Development*, 42 N.Y.U. J. INT'L L. & POL. 1091, 1091–93 (2010).

80. HUDSON INST. CENTER FOR GLOBAL PROSPERITY, THE INDEX OF GLOBAL PHILANTHROPY AND REMITTANCES 15 (2009); Little, *supra* note 79, at 1091–93.

81. I.R.C. § 170(c)(1) (2010).

82. Support came from private foundations ($5.4 billion), private and voluntary organizations ($14.3 billion), religious organizations ($8.6 billion), corporations ($6.8 billion), and colleges and

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provision of foreign aid is a good indication of preferences for the geographic focus of government expenditures, then perhaps the public favors preferential tax treatment for domestic charitable activities over foreign activities.[83] The tax law in other countries varies greatly, as some countries require all donated funds to be used within the home country and other countries impose no geographic limitations on the use of funds.[84]

U.S. charitable organizations have a long tradition of overseas assistance, mostly rooted in missionary efforts in Africa, Asia, and South America.[85] Putting aside for a moment the difficult line-drawing questions of religious and humanitarian activity, using government funds to support these efforts raises many difficult questions. Current foreign assistance efforts are also problematic. The Gates Foundation spent $2.5 billion in 2009 to support its charitable efforts outside the U.S., including its efforts to combat malaria in Africa.[86] In addition to the roughly $2–3 billion in annual economic and military aid that Israel receives through direct assistance from the U.S. government, U.S. individuals make hundreds of millions of dollars in tax-deductible charitable contributions to U.S. charities that fund activities in Israel, including a reported $33 million in tax-deductible contributions to fund the building of settlements in disputed territories.[87] Finally, I suspect, but do not know, that matching government dollars are likely funding both sides of the conflict regarding the Anti-Homosexuality Bill in Uganda, with participation by both American evangelical churches and by human and gay rights groups funded by tax-deductible charitable contributions.[88]

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universities ($3.9 billion). IRS, ADVISORY COMM. ON TAX EXEMPT & GOV'T ENTITIES, PUB. 4344, EXEMPT ORGANIZATIONS: RECOMMENDATIONS TO IMPROVE THE TAX RULES GOVERNING INTERNATIONAL GRANT MAKING 3 (2009).

83. For example, in 2002, only 45% of the U.S. population was in favor of increasing foreign financial aid. This was much lower than in other countries such as the United Kingdom (69%), Canada (64%), Australia (63%), or Germany (68%). The only country in a similar range to the U.S. is Japan, which also has only 45% of the population's support for an increase in foreign aid. Pamela Paxton & Stephen Knack, *Individual and Country-Level Factors Affecting Support for Foreign-Aid* 27 (World Bank, Policy Research Working Paper No. 4714, 2008).

84. Brazil, Russia, and Thailand condition tax deductibility on use of funds within the country, while Italy, Poland, and South Africa allow charitable tax deductions without regard for where the funds are used. *See* Pozen, *supra* note 10, at 546 n.67. *See generally* LESTER M. SALAMON, THE INTERNATIONAL GUIDE TO NONPROFIT LAW (1997).

85. Appendix C, *infra*, provides a relatively current distribution of U.S. nonprofit international assistance efforts by region.

86. BILL & MELINDA GATES FOUND., 2009 ANNUAL REPORT 12 (2009).

87. HILLEL SCHMID & AVISHAG RUDICH, SOCIAL ENTREPRENEURSHIP AND THE ISRAELI REALITY, INTERNATIONAL CONFERENCE, THE IMPLICATIONS OF THE DECLINE IN PHILANTHROPY ON ISRAELI NONPROFIT ORGANIZATIONS AND SOCIAL SERVICES 5 (2008); David Ignatius, *A Tax Break Fuels Middle East Friction*, WASH. POST, Mar. 26, 2009, at A21.

88. *See* Warren Throckmorton, *A U.S. Church and Its "Kill the Gays" Partner in Uganda*, SALON.COM (July 2, 2010, 4:01 AM), http://www.salon.com/news/feature/2010/07/02/church_uganda_gays_bill.

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Should the Gates Foundation decide which diseases and which African countries merit matching funds? Should a relatively small group of donors influence the flow of matching dollars to Israel rather than much poorer, and, by some measures, needier developing countries? And should government funds support either side of the Ugandan anti-homosexuality debate?

In his blog, Judge Richard Posner raised the question of whether Americans should get tax deductions for gifts to domestic charities that donate or operate abroad.[89] Judge Posner argues against allowing such deductions.[90] His opposition does not rest on the grounds that U.S. government foreign aid projects are more efficient than private activities. Nor does he challenge a traditional rationale for all charitable deductions: that the external benefits associated with charitable giving and the tendency of rational individuals to free ride on the charitable efforts of others results in the underprovision of certain goods and services.

Judge Posner puts forth three major grounds for denying charitable deductions for foreign activities: (1) He believes that denying deductions for foreign charitable activities will increase funds available for domestic charitable activities (the "substitution effect"),[91] (2) he believes that denying deductions for foreign charitable activities will reduce the overall level of charitable contributions so that the tax subsidy for charitable contributions will decrease, and overall tax revenues will increase (the "revenue effect"),[92] and (3) he suspects that giving to poor people in the U.S. may create greater utility as compared to giving to poor people in developing countries—as foreign donations reduce the pressure for desperately needed political, economic, and social reforms (the "Mugabe effect").[93]

As a blog post, this explanation likely just reflects Judge Posner's initial reactions to the question of the relative merits of domestic and foreign charities. Nonetheless, the post is a good overview of the general considerations at work, and it is useful to unpack some of the reasoning behind Judge Posner's intuition. There are several possible reasons to favor substitution away from foreign activities and toward domestic activities. First, one could value the direct assistance to domestic recipients more than transfers to foreign beneficiaries. There is a strong

89. Richard Posner, *Tax Deductions for American Charitable Donations Abroad*, BECKER-POSNER BLOG (Mar. 15, 2009, 5:29 PM), http://www.becker-posner-blog.com/2009/03/tax-deductions-for-american-charitable-donations-abroad--posner.html. Economist Gary Becker responded in the same post that opposition to deductions for donations to foreign charities was just a cover for protectionism, in this case protecting domestic charitable organizations from competition with foreign organizations. *Id.*

90. *Id.*

91. *Id.*

92. *Id.*

93. *Id.*

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intuitive appeal to helping those closer to us (both geographically and culturally) than those outside our borders. Second, if we focus only on the overall welfare of our society (defined by national borders), then it is likely that more of the externalities generated by domestic charitable activities will remain in our country. Finally, if we view part of the bargain of providing tax benefits for charitable contributions as relieving government of the obligation of providing the goods and services directly, then favoring domestic activities over foreign activities may reduce the demand for domestic government spending. Each of these reasons would support a regime that privileged charitable assistance to victims of Hurricane Katrina over charitable assistance to victims of the Japanese earthquake and tsunami.

All of these arguments are subject to strong counterclaims. It is hard to make comparisons between deserving individual recipients in the U.S. and abroad. Questions as to who are the more deserving beneficiaries raise difficult value judgments that are hard to evaluate without some normative framework. And it is difficult to take such a narrow view of society in measuring general welfare, especially given the international consequences of many local challenges. Finally, foreign charitable activities may well result in less direct U.S. government assistance to foreign countries.

Giving preference to domestic, rather than foreign, altruism for revenue reasons is also not clear-cut. If the goal is to limit the revenue cost from charitable contributions, there are probably several alternatives that could reduce the lost revenue, some with relatively little effect on charitable giving. For example, there have been several proposals to provide for charitable deductions only for those contributions in excess of 1% or 2% of adjusted gross income.[94] If the revenue cost from charitable contributions is considered too large, it is not obvious without some normative framework that the place to start chopping is support for foreign charitable activities. The U.S. generally provides the same tax benefits to all types of charitable activities, even though one could imagine a regime where certain activities that generate higher levels of societal benefits (through greater externalities) receive greater tax benefits than activities where most of the benefits are captured by those making the contributions.

Finally, a blanket prohibition on tax benefits for deductions for all foreign charitable activities because of Mugabe and Mugabe-lite circumstances makes little sense. It is a big hammer, and it may hit the downtrodden people as much or more than the repressive regime.

94. One recent proposal would allow itemizers to deduct the amount of their charitable donations in excess of 2% of their adjusted gross income. CONG. BUDGET OFF., *supra* note 26, at 9–11.

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My objective here is not so much to question Judge Posner's intuition about the relative merits of domestic versus foreign altruism, but rather to highlight some of the challenges in trying to frame the theoretical and policy issues in deciding whether, how, and how much to use the tax system to subsidize any charitable activity and whether to favor charitable activities in the U.S., as compared to charitable activities outside our borders. The decision to provide a tax subsidy for contributions to domestic charities for charitable activities in the U.S. does not rest on a simple, comprehensive theory but rather a set of trade-offs that balance the costs and benefits of using tax dollars to subsidize domestic charitable activities. It is not clear that the same set of trade-offs would apply in the foreign context or that policymakers need adopt the same tax regime for charitable contributions for foreign activities.

B. TAX SCHOLARSHIP

Tax scholars have taken different approaches in examining the justifications for tax benefits for charitable activities. With respect to tax deductibility of charitable contributions, the literature falls into two general categories. One group of scholars focuses primarily on the donor. They justify allowing tax deductions for charitable contributions based on considerations of designing the proper base for taxation and income measurement. A mostly different group of scholars justifies tax benefits for charitable deductions as a subsidy for collective goods and services. The difference is important. The donor-based theories are rooted in the design of a tax system. In contrast, the subsidy-based theories seek to use the tax system as a means to achieve non-tax objectives, in this case increasing incentives for private donors to support and monitor charitable activities and providing matching funds to supplement their efforts.

1. Donor-Oriented Approaches

Early examinations of the role of charitable deductions in an ideal tax system worked within the Haig-Simons framework, which defines income as the sum of personal consumption ("private preclusive use") plus wealth accumulation over a given time period.[95] Considering this definition of income, amounts transferred as charitable contributions are not income to the donor because they do not result in exclusive personal consumption. Instead, such contributions create common goods whose enjoyment is not confined to contributors, nor apportioned among contributors according to amounts of contributions.[96] In contrast to other

95. William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309, 313, 320–21 (1972).

96. *Id.* at 346.

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approaches, under the donor-oriented approach there is no effective government subsidy for charitable contributions, as such amounts are not considered income in the first place.

Alternatively, but still considering the perspective of the donor, a charitable deduction should be allowed because it equitably accounts for loss of welfare by the donor.[97] Society should reward those who transfer private resources for the public good. In addition, as donations often derive from perceived moral obligations, the involuntary nature of the transfer should not require the donor to be taxed on such amounts.

Serious challenges have been offered to both of these donor-oriented approaches.[98] What is striking is how relatively poorly these theories have held up over time. While they reflect a common intuition that money (or other property) transferred to charity should qualify for income tax deductions, the theoretical basis for charitable deductions as a way of accurately measuring income remains shaky.

These donor-focused theories provide little guidance as to what types of charitable activities warrant support or whether giving for domestic activities should be preferred over giving for foreign charitable activities. As long as the donor gives up control of the property, it does not matter how or where the donated resources are actually used. These theories justify the tax deduction because donors are worse off as a result of their charitable donations. To the extent that geographic distance between the donor and the beneficiaries makes it harder for a donor to achieve reputational, social, or financial advantages from donations, an argument could be made that the donor-centric theories favor giving to foreign charitable activity over domestic activity.[99] However, in the age of Bono and Angelina Jolie, for many donors it may be more chic to give globally rather than locally, so physical distance may no longer serve to separate donors from the direct or indirect (psychological) benefits of the donations.

2. Subsidy-Oriented Approaches

A second common approach is to justify the charitable deduction (and other tax benefits) as a subsidy for certain types of underprovided collective goods and services. There are several strands of the subsidy literature, focusing on different types of market failure or government failure. The market failure arguments generally start with examination of

97. Boris I. Bittker, *Charitable Contributions: Tax Deductions or Matching Grants?*, 28 TAX L. REV. 37, 46–49 (1972).

98. *See generally* Gergen, *supra* note 14 (concluding that the loss-of-welfare theory is valid, but subject to significant constraints); Mark G. Kelman, *Personal Deductions Revisited: Why They Fit Poorly in an "Ideal" Income Tax and Why They Fit Worse in a Far from Ideal World*, 31 STAN. L. REV. 831 (1979) (discounting true altruism).

99. Pozen, *supra* note 10, at 573.

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public goods—those goods where one person's consumption does not reduce availability to others ("nonrival") and there is no way to exclude others from enjoying the good ("nonexclusive").[100] Such goods will be undersupplied because self-interested individuals will choose to free ride on the charitable activities of others rather than pay to support the goods and services themselves.[101] As a practical matter, most goods provided by governments are rival and excludable. These goods and services include schools, hospitals, roads, and various transfer payments.[102] But these goods and services can generate externalities that are not fully captured by market participants.[103] There is thus a role for charities (and governments) to supply such goods where there are substantial secondary benefits.

Some types of goods and services provide elements of public goods and private assistance. For example, disaster relief for hurricane and earthquake victims is an example of pure public goods if one focuses on the benefits that accrue to society generally rather than the specific private assistance given to the individuals or the specific pleasures donors receive from making the contributions.[104] Donors to charitable relief efforts get the satisfaction of seeing their dollars help relieve the suffering caused by natural disasters. But non-donors also get psychological benefits from seeing a reduction in suffering. They can free ride off the generosity of others. Allowing a tax deduction for charitable contributions thus both increases the amount of funds going to these types of relief efforts (correcting a suboptimal level of funding) and imposes costs on those uncharitable individuals (making them involuntary contributors to these causes).

Support for tax subsidies for charitable contributions also rests on potential failures that may be inherent in the government decisionmaking process. If we leave all spending decisions to the political process, the level of collective goods and services would be decided by majority rule. The tax subsidy for charitable contributions allows, at least for certain types of goods and services, the preferences of a minority of voters who have a greater taste for certain collective activities to receive government support, as long as they are willing also to pay for them.[105] This decentralized approach allows for greater diversity, innovation, and other benefits.[106] Under this view, the greater the heterogeneity of preferences

100. *See* Gergen, *supra* note 14, at 1397; *see also* ROBIN W. BOADWAY & DAVID E. WILDASIN, PUBLIC SECTOR ECONOMICS 57–60 (2d ed. 1984).

101. Gergen, *supra* note 14, at 1398.

102. *Id.*

103. *Id.* Market failures could also result from other causes, such as information asymmetries.

104. *Id.* at 1397–98.

105. Levmore, *supra* note 15, at 405–06.

106. *Id.* at 408–12.

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for collective goods, the stronger the case for tax subsidies for charitable contributions.

But who should decide which types of goods are underprovided by either the government or the market? Under the current regime of matching charitable contributions, individual donors can direct government spending while bypassing majority approval. Minority preferences dictate government spending patterns.[107] This tax regime allows Harvard, NYU, Yale, and UCLA to receive the lion's share of matching tax dollars directed for higher education (rather than community colleges or historically black colleges)[108] and results in the U.S. government providing greater financial subsidies to charities in Israel than to charities in poor developing countries.[109] It may be that donors got it exactly right in allocating the federal funds to deserving educational institutions and deserving foreign countries in a way that reflects popular preferences and maximizes social returns,[110] but I doubt it. The harder question is whether they, as a group, can do a better job than Congress, the Departments of Education or State, some band of experts, or a matching grant program that allocated funds based on different criteria than the current tax regime. For our purposes, it is remarkable how little guidance these subsidy theories provide on such basic questions as which types of activities should qualify for favorable tax treatment and whether to extend tax deductions for foreign charitable activities. While the subsidy theories may provide general support for the government matching of private contributions, they do not tell us what types of activities to support, how much, or in which countries. Attempts to rank charities as to their relative worthiness based on purpose and effectiveness of performance face substantial obstacles.[111] This is perhaps unsurprising given both the difficulty of achieving political consensus on those activities that are more or less worthy and of assessing the relative efficiency and effectiveness of performance.

Part of the challenge in thinking about tax subsidies for charities is the sheer number of and diversity within charitable organizations. In 2009 there were approximately 1.6 million nonprofit organizations, including almost 400,000 religious congregations, which are not required

107. Ilan Benshalom, *The Dual Subsidy Theory of Charitable Deductions*, 84 IND. L.J. 1047, 1063 (2009); Ray D. Madoff, *What Leona Helmsley Can Teach Us About the Charitable Deduction*, 85 CHI.-KENT L. REV. 957, 966 (2010).

108. In a 2010 survey, the top twenty colleges and universities represented about 2% of the total number of institutions but received about 25.5% of all 2010 gifts to higher education institutions. COUNCIL FOR AID TO EDUC., COLLEGES AND UNIVERSITIES RAISE $28 BILLION IN 2010, at 2 (2011).

109. *See supra* note 87 and accompanying text.

110. This need not be due to donors having preferences different from the socially optimal distribution. An inefficient distribution of charitable giving would likely occur simply from information asymmetries.

111. *See generally* Schmalbeck, *supra* note 32.

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to file with the IRS.[112] In terms of spending, health service organizations account for 59% of total nonprofit spending, with educational organizations accounting for an additional 17%.[113] In terms of tax subsidies, the Joint Committee on Taxation estimates that for 2010, charitable deductions for educational institutions will result in tax expenditures of $5.5 billion, for health organizations will result in tax expenditures of $4.3 billion, and for charitable organizations other than education and health, including religious organizations, will result in tax expenditures of $30.2 billion.[114] Charitable organizations also vary greatly in the proportion of revenues that comes from fees for services rather than donations and grants.[115]

One's enthusiasm for using tax subsidies for charitable contributions is likely influenced by both the ability of the IRS and states' attorneys general to monitor the activities of the charities and by how effective federal funds are in increasing the level of underprovided goods and services. The apparent unwillingness of the IRS to provide meaningful review of applications for tax-exempt status and the difficulty for both the IRS and state officials of monitoring effectively the large number of charities under their supervision undermine our confidence that a significant amount of donors' funds and federal matching funds are being well spent on charitable activities, or at least that they could not be better spent by other charitable organizations. Even where there is no improper use of funds, there may be a mismatch between theories supporting tax subsidies and the types of charities receiving those subsidies.

A strong case can be made for subsidizing charities providing disaster relief and social welfare services because of market failures in the level of services that would exist without government intervention. This fits nicely with a "plain-meaning" and historical view of charity.[116] The case for subsidization of many other types of charities under market failure theories is much weaker.[117] Operas, museums, and private schools

112. *Number of Nonprofit Organizations in the United States,* 1999–2009, NAT'L CTR. FOR CHARITABLE STAT., http://nccsdataweb.urban.org/PubApps/profile1.php (last visited Dec. 23, 2011). Classifying a nonprofit as "religious" is difficult due to IRS reporting requirements.

113. James R. Hines, Jr., et al., *The Attack on Nonprofit Status: A Charitable Assessment*, 108 MICH. L. REV. 1179, 1185 (2010).

114. STAFF OF J. COMM. ON TAX'N, 111TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2010–2014, tbl.1, at 43–48 (Comm. Print 2010) (including corporate and individual deductions).

115. Dennis R. Young, *Nonprofit Revenue Streams: Finding the Right Mix*, MANDEL CTR. FOR NONPROFIT ORGS. 9–10 (May 20, 2004), http://www.nationalcne.org/index.cfm?fuseaction=feature.display&feature_id=81.

116. Charity is the "voluntary giving of help, typically in the form of money, to those in need." THE NEW OXFORD AMERICAN DICTIONARY 288 (2001).

117. In the domestic context, Mark Gergen is one of the few scholars to examine specific activities under different justifications for tax subsidies. He finds that contributions to social welfare agencies are supported on both subsidy and equity grounds. Other types of charitable activities do not fare as well under the Gergen approach. Contributions to public television fail to satisfy either the subsidy or

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are examples of what may be called "club goods"—goods that can be fenced and made available only to members.[118] The case for subsidies to these entities is much less compelling. While these organizations produce some spillover benefits to society at large, most of the benefits are enjoyed by their members.

Historically, churches were one of the primary providers of assistance to the poor, ill, and helpless.[119] They provide an effective collective mechanism for matching donors to needy beneficiaries. Today, however, some scholars contend that only a small percentage of funds (approximately 12%)[120] go to charitable activities for the poor, with the vast majority (70–80%) going to property improvement or operating expenses, such as salaries that benefit church members primarily.[121] While churches generate benefits to the community and to society, even putting aside issues of using government funds to support religious activity, it is not clear that this justifies full deductibility of contributions to religious organizations.

These subsidy theories often seem to support extension of the charitable deduction to foreign charitable activities.[122] For example, if the rationale for tax subsidies for charitable contributions rests on government or market failures, then those societies with great failures may benefit the most from receiving charitable assistance. Law and development scholars generally contend that governments (and other providers) may have a greater role to play where markets function poorly.[123] Particularly for low-income and middle-income countries, the size of government is correlated with per capita income, and many developing countries lack resources to provide for certain basic collective goods and services.[124] But while there is a clear need for assistance in many low-income and middle-income foreign countries, it is not clear who should provide the assistance and what the form the assistance should take.

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equity theory, while church-related expenditures do well under an equity theory but poorly under a subsidy theory. Gergen, *supra* note 14, at 1433–49.

118. *Id.*; Brian Galle, *The Role of Charity in a Federal System* 9 (Fla. State Univ. Coll. of Law, Pub. Law Research Paper No. 394, Bus. & Econ. Paper No. 09-25 2011), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1473107.

119. *See generally* Robert A. Gross, *Giving in America: From Charity to Philanthropy*, *in* CHARITY, PHILANTHROPY, AND CIVILITY IN AMERICAN HISTORY 29 (Lawrence J. Friedman & Mark D. McGarvie eds., 2003) (discussing Christian charity's early charitable purposes in America).

120. SUSAN K. E. SAXON-HARROLD ET AL., AMERICA'S RELIGIOUS CONGREGATIONS: MEASURING THEIR CONTRIBUTION TO SOCIETY 5 (2000) (using 1996 survey data).

121. *Id.*

122. Pozen, *supra* note 10, at 574–87. Appendix D, *infra*, provides information about the types of foreign charitable activities supported by U.S. nonprofit organizations.

123. Robin Burgess & Nicholas Stern, *Taxation and Development*, 31 J. OF ECON. LITERATURE 762, 764–66 (1993).

124. In many countries, however, simply providing additional funds to governments may not be a good approach. Where government is inefficient and corrupt, smaller governments may be better.

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Mitchell Kane offers an interesting example that nicely highlights some of these issues.[125] Assume the U.S. and another country are identical in every respect, including a currently underprovided public good and the same absolute levels of individual utilities in both countries.[126] Assume also the benefits of the externalities from the public good are enjoyed entirely locally.[127] Should the U.S. tax its individual and corporate taxpayers to provide the same level of public goods in both countries?[128]

As a matter of domestic tax policy, Kane argues that the answer is clearly no.[129] Despite calls by moral philosophers advocating greater cosmopolitan responsibilities, tax and spending policies in the U.S. are driven by the gains to its citizens and residents rather than to foreign beneficiaries.[130] We give greater weight to the utilities of our citizens and residents and discount the utilities of foreigners.[131] If we cannot justify using general tax revenue to fund foreign charitable activities, we should not use the charitable deduction as a means of providing public goods outside the U.S. Kane thus finds a strong case for preferring tax benefits for domestic rather than foreign charitable activities.[132] Following this logic, our tax system should give preference to donations made to Harvard and the Metropolitan Opera over donations made to Oxford University and the Royal Opera House.

Relaxing some of the assumptions of Kane's example muddies the water. Consider charitable transfers from U.S. donors to a U.S. charity that provides support for victims of the Japanese earthquake and tsunami. These transfers provide utility both to the foreign recipients of the assistance and to the U.S. donors (and perhaps other U.S. individuals who appreciate both the willingness of others to donate for these causes and the use of matching federal funds for this particular purpose). It is not clear that our tax system should prefer donations made to the Metropolitan Opera over donations made to charities that help those less fortunate, even if the direct beneficiaries are outside the U.S.

Changing the focus from subsidies based on market failure to subsidies based on political failure helps little in deciding whether the charitable deduction should be extended to foreign charitable activities. It is not clear that the same considerations that may support allowing donors to decide in the domestic context apply with the same force for foreign charitable activity. Again, these theories are based on the notion

125. Kane, *supra* note 39.
126. *Id.* at 4.
127. *Id.*
128. *Id.*
129. *Id.*
130. *Id.*
131. *Id.*
132. *Id.*

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that private charity responds better to differences in demand for collective goods than does the government. This assumes broad participation by a large group of donors supporting many different types of activities. But it seems likely that allowing a charitable deduction for contributions for foreign activities would concentrate disproportionate influence among certain groups, such as supporters of Mormon missionary activities, supporters of Israeli causes, and a handful of wealthy donors.

Even if we decide as a matter of tax policy that the charitable deduction should not be extended to foreign charitable activities, this does not mean that there is no role for the government's use of tax benefits to support foreign charitable activities.[133] Assume, for example, that the U.S. government decides to provide $10 billion in funding in 2011 for humanitarian aid to Africa. We could choose to provide the $10 billion directly through direct foreign assistance funded out of general tax revenue, or allow charitable deductions at a revenue cost of $10 billion to subsidize private assistance efforts in Africa. The question then becomes which alternative (or combination of the two) yields the greatest benefit—both in terms of choice of projects and the quality of the outputs. For certain types of activities and projects, private providers may have clear advantages over direct government foreign assistance.[134] Providing additional funds to the Gates Foundation's efforts to combat malaria in Africa may be more productive than providing financial assistance to African governments to fund government-operated health facilities or to projects selected and monitored by the U.S. government.

The existing charitable subsidy literature also fails to address several issues that arise in cross-border philanthropy. For example, the leading theory of government failure ties inadequate levels of collective goods and services to the preferences of the majority trumping those interested minorities with money to contribute.[135] This theory assumes a single society in which the voting, contributions, and subsidies take place.[136] Once charitable activities cross borders, the interests of other groups should be part of the analysis. We sometimes assume that the recipients of charity value whatever they receive and, if they do not want it, they can simply turn it down.

But it often does not work that way. With charitable assistance comes economic, social, and political influence. The Saudi Arabian government has made contributions to the William J. Clinton Foundation (as have the governments of Italy, Kuwait, Norway, and

133. *Id.* at 5.
134. *See supra* note 16 and accompanying text.
135. *See supra* notes 102–08 and accompanying text.
136. *See supra* notes 102–08 and accompanying text.

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Qatar),[137] the CITGO-Venezuela Heating Oil Program has donated millions of gallons of crude oil to a U.S. charity that provides assistance to needy homeowners,[138] and a charity that may be linked to the Iranian government donated $100,000 to Columbia University in advance of President Mahmoud Ahmadinejad's speech in September 2007.[139] While the flow of charitable contributions into the U.S. is just a trickle, donor-provided assistance constitutes a large portion of many economies in developing countries. Theories that simply look at the preferences of the donors and the level of government subsidies, but not the preferences of the recipients, likely will not be useful in examining issues related to foreign charitable activities.

Similarly, U.S. scholars have generally adopted a U.S.-centric view of government, the private sector, and the nonprofit sector. In this relatively simple world, existing subsidy theories reflect that the goods and services could be provided by any of these three actors. In developing countries, the cast of characters is much larger. They include such other players as multilateral institutions, foreign governments, bilateral aid agencies, and foreign charities. Each has relative advantages and disadvantages in providing development assistance. Again, richer theories are required to incorporate the complexities of different providers of assistance in determining the usefulness of tax subsidies for charitable contributions for foreign activities.

Where does this leave us? We do not have a comprehensive theory that supports the automatic extension of the existing charitable-deduction regime for contributions to fund the domestic activities of domestic charities to cover contributions to fund foreign charitable activities. Merely showing that several of the existing theories provide no clear basis for distinguishing between domestic and foreign charitable activities is not sufficient to justify adopting a geographically neutral policy. If we adopt the "take it or leave it" approach to the charitable deduction, then we need to show that the trade-offs that balance the costs and benefits of using tax dollars to subsidize domestic altruism would result in a similar determination for foreign altruism—even recognizing that the specific trade-offs in the domestic context will be different in the foreign context. The "bang for the buck" approach would perhaps support tax subsidies for foreign charitable activities, though not necessarily in the same form that applies to purely domestic activities.

137. Philip Rucker, *The Near, Far, Left—Even Right—Aided Clinton Group*, WASH. POST, Jan. 2, 2010, at A2; *Foreigners Gave Millions to Clinton Foundation*, MSNBC.COM (Dec. 18, 2008), http://www.msnbc.msn.com/id/28295539#.

138. For a description of the program, see *Program Overview*, CITGO-VENEZUELA HEATING OIL PROGRAM, http://www.citgoheatingoil.com/program_overview.html (last visited Dec. 23, 2011).

139. A.G. Sulzberger, *Foundation Tied to Iran Has Donated to Columbia*, N.Y. TIMES, Nov. 24, 2009, at A30.

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There are several alternatives for differentiating between domestic and foreign charitable activities. At one extreme, we could disallow charitable deductions for amounts spent on foreign charitable activities. Less severe restrictions include per-country limitations or allowing only a certain percentage of amounts allocated to foreign charitable activities to qualify for tax benefits. Finally, we could impose more restrictive provisions as to the type of foreign activities that qualify for tax benefits, recognizing that some activities provide benefits to a narrow group of beneficiaries (support for the Royal Opera House in England) as compared to a broader group of beneficiaries (support for disaster relief efforts).

III. Should the Tax System Treat Foreign Charities Differently from Domestic Charities?

If the decision is made to allow tax subsidies for foreign charitable activities, then the question becomes which charities should provide such goods and services. Should the tax law provide different tax treatment based on the charity's place of organization? While my focus here is on the tax deductibility of charitable contributions to foreign and domestic charities, the U.S. tax regime provides several other provisions that disadvantage funding of foreign, as compared to domestic, charitable activities.[140]

A. General Considerations

With limited exceptions, the tax law adopts a "water's-edge" policy by allowing donors to deduct for income tax purposes only contributions made to donees "created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States."[141]

The income tax regime initially allowed tax deductions for contributions made to foreign charities.[142] This "place-of-organization"

140. *See generally* Dale, *supra* note 22 (discussing the lack of tax-exempt status for foreign charities). For example, tax law applies several "place of use" restrictions. Corporate donors may generally not deduct charitable contributions unless the funds are used for domestic purposes. However, this limitation applies only to recipients that are trusts or unincorporated associations; it does not apply to corporate donees. I.R.C. § 170(c)(2) (2010). Thus, corporate donors can easily avoid the place-of-use limitation by giving contributions to corporate donees. Private foundations must satisfy additional requirements if they make grants to foreign, as opposed to domestic, organizations. Private foundations must either make an equivalency determination or exercise expenditure responsibility for foreign grant making in order to have foreign grants be counted toward minimum distribution requirements and to avoid excise taxes on prohibited taxable distributions. I.R.C §§ 4942, 4945 (2010).

141. I.R.C. § 170(c)(2)(A) (2010). The limitation applies even if the foreign charity qualifies for tax-exemption under I.R.C. § 501(c)(3) (2010).

142. Dale, *supra* note 18, at 660.

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restriction was adopted in 1938.[143] Here is the often-cited passage in the legislative history of the Revenue Act of 1938:

> The exemption from taxation of money or property devoted to charitable or other purposes is based upon the theory that the Government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds, and by the benefits resulting from the promotion of general welfare. The United States derives no such benefit from gifts to foreign institutions, and the proposed limitation is consistent with the above theory.[144]

This limitation has been persuasively described as bad history, bad philosophy, and bad logic.[145] It is bad history because there was no Congressional quid pro quo requirement that charitable activities relieve the government of an expense before allowing deductibility.[146] This requirement would not be satisfied by many types of domestic activities that qualify for tax benefits even though the government is not relieved of obligations to provide similar good or services. Also, because of the current level of private assistance for foreign charitable activities, the U.S. government may be relieved of the burden of providing different types of foreign aid. It is also bad philosophy, as even in the 1930s this was a narrow view of the world in general and of global philanthropy in particular.[147] Finally, it is bad logic.[148] It makes little sense to deny a charitable deduction on the basis of where the entity is organized but to allow charitable deductions to domestic entities that use some or all of their funds outside the U.S.[149]

At one level, the place-of-organization restriction merely increases the transaction costs of providing funds for charitable activities outside the U.S. Individuals can donate to public charities or private foundations in order to structure their giving to avoid restrictions on direct contributions to foreign charities. It is also easy for many established foreign charities to create "friends of" organizations. These organizations are established to allow U.S. contributors to make donations to a U.S. entity that then transfers amounts to a specific charitable organization outside the U.S.[150] As long as the organization does not act as a mere

143. *Id.* (stating that the restriction was adopted in 1938 for individuals and in 1935 for corporations).

144. H.R. REP. NO. 75-1860, at 19 (1938).

145. Dale, *supra* note 18, at 660, 661.

146. *Id.* at 660–61.

147. *Id.* at 661.

148. *Id.*

149. *Id.* A domestic corporation's "activities are charitable within the meaning of section 501(c)(3) of the Code when carried on within the United States, the conduct of such activities elsewhere does not preclude the organization from qualifying as an exempt organization under that section." Rev. Rul. 71-460, 1971-2 C.B. 231.

150. The "friends of" organizations must meet certain statutory requirements and must file annual returns with the IRS. *See* Rev. Rul. 69-80, 1969-1 C.B. 65.

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conduit to the foreign charity, U.S. donors can secure deductions for charitable contributions that are effectively made to foreign charities.[151]

Internet platforms also allow for U.S. donors to choose foreign beneficiaries by effectively using the public charity status of a charitable intermediary. These platforms reduce transaction costs for individuals seeking to fund foreign projects. For example, GlobalGiving provides individuals with funding opportunities for education, health, and other types of projects in different countries.[152] While these organizations do provide some oversight as to how funds are spent, because of their public charity status they are not subject to the strict expenditure responsibilities applicable to private foundations.[153]

Assume for purposes of this discussion that there was no problem in monitoring the activities of either domestic or foreign charities (or that the proportion of charities behaving badly was the same), and assume that it is already possible to give deductible donations to foreign organizations, albeit with higher transaction costs. It seems that under these assumptions, we would want those organizations that were the most efficient providers of charitable services to receive tax subsidies. There seems little reason for the U.S. tax system to favor less effective U.S. charities over more effective foreign charities. We should want the donations and the matching federal funds to go to the charities that provide the highest quality assistance.[154]

Strong arguments also exist for allowing U.S. donors to take advantage of regulatory regimes that are more effective in approving and monitoring charities than are the IRS and state attorneys general. The United Kingdom's Charity Commission likely provides more effective oversight of U.K. charitable organizations than do U.S. oversight mechanisms.[155]

The strongest rationale for requiring a domestic entity as a pass-through for funds sent overseas is to increase accountability and transparency. This allows the IRS and state governments to have some oversight of the activities, even though the funds are spent outside the U.S. If deductibility under Internal Revenue Code section 170 requires the IRS to determine that the contributions are used exclusively for

151. *See* Rev. Rul. 74-229, 1974-1 C.B. 142.

152. *See About Us*, GLOBALGIVING, http://www.globalgiving.org/aboutus/ (last visited Dec. 23, 2011).

153. *See supra* note 65.

154. For example, Israeli charities provided assistance to Haiti by funding aid groups with substantial experience in recovery and rescue efforts, medical assistance, and structural engineering. *Israeli and Jewish Aid Groups Provide Relief to Haiti*, ISRAEL PROJECT, http://www.theisraelproject.org/site/apps/nlnet/content3.aspx?c=asIOI5NJKeK0F&b=7676971&ct=11139149#.Tp5Zgs30Izw (last visited Dec. 23, 2011). Under current law, U.S. donors would not be allowed to deduct amounts contributed to Israeli charities even though these charities may be the most effective aid providers.

155. Kevin E. Davis & Anna Gelpern, *Peer-to-Peer Financing for Development: Regulating the Intermediaries*, 42 N.Y.U. J. INT'L L. & POL. 1209, 1261–63 (2010).

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charitable purposes and that no part of the earnings inure to the benefit of any private individual, it is important to have a U.S. intermediary, especially where the IRS lacks the ability and authority to audit activities outside the U.S.[156]

Oversight concerns take on added importance in the post-September 11, 2001 world. The use of charitable organizations to support terrorist activities makes the cost of abuses related to foreign charitable activities greater than just wasted U.S. tax dollars. While requiring foreign charities to use a U.S.-based intermediary may not be entirely effective in limiting the flow of funds to terrorist organizations, it potentially provides some help in limiting such abuses.[157]

If we wish to extend tax benefits to foreign charities, then there are several alternatives that may facilitate donations while minimizing chances of abuse.[158] First, foreign charities could apply for the right to receive tax-deductible contributions in the same way they can currently apply for tax-exempt status, just as foreign publicly held corporations are required to comply with certain disclosure and other requirements to have their stock listed on national stock exchanges.[159] Second, we could adopt an "approved foreign charity list" of those foreign charities that satisfy certain criteria based on a review by the IRS or the State Department, or some other agency. This approach shares much in common with the current Canadian system, in which individual taxpayers are allowed to deduct contributions to foreign charities as long as the Canadian government also has contributed to those charities.[160] Third, the existing tax-treaty network could be used to provide for deductibility of contributions to foreign charities on a country-by-country basis. Currently, the U.S. provides treaty relief for U.S. residents, generally allowing them to reduce their foreign-source income through donations to charities in Canada, Israel, and Mexico.[161] Finally, we could adopt a

156. *See* Peter J. Wiedenbeck, *Charitable Contributions: A Policy Perspective*, 50 MO. L. REV. 85, 103 (1985).

157. *See, e.g.*, U.S. DEP'T. OF THE TREASURY, ANTI-TERRORIST FINANCING GUIDELINES: VOLUNTARY BEST PRACTICES FOR U.S.-BASED CHARITIES (2002) (suggesting charities use governing instruments, independent oversight, publication of key employees, and records to account for disbursements, among other suggestions to help ensure donations are directed towards charitable purposes).

158. Pozen, *supra* note 10, at 594–96.

159. Foreign charities currently can apply for tax-exempt status in the U.S. to qualify for certain federal, state, and local tax benefits.

160. *See* CAN. REVENUE AGENCY, NO. IC84-3R6, GIFTS TO CERTAIN CHARITABLE ORGANIZATIONS OUTSIDE CANADA (2010).

161. Convention Between the Government of the United States of America and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, U.S.-Mex. art. 22, Sept. 18, 1992, S. TREATY DOC. NO. 103-7 (1993); Convention with Respect to Taxes on Income and on Capital, U.S.-Can. art. XX, Sept. 26, 1980, T.I.A.S. NO. 11,087; Convention Between the Government of the United States of America and the Government of the State of Israel with Respect to Taxes on Income, U.S.-Isr. art. 23, 25, Nov. 20, 1975, S. TREATY DOC. NO. 103-7 (1981). If this alternative is adopted, then the benefits could be

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"substantial equivalent" approach, where charities in those countries whose charitable regulations meet some minimum guidelines would be eligible to receive deductible contributions.

B. Consequences of Extending Tax Benefits to Foreign Charitable Activities

There are three major consequences of extending greater tax benefits to foreign charitable activities, whether in the form of less restrictive rules for domestic charities engaged in development assistance or allowing deductions for contributions made directly to foreign charities: (1) the potential effects on the quality and quantity of goods and services provided, (2) the interaction with other providers of development assistance, and (3) the substitution away from support to domestic charities.

1. Effects on Quality and Quantity

The desirability of extending tax benefits to foreign charitable activities depends largely on the effectiveness of foreign charities in providing assistance as compared to other alternatives. A key question is how, and how much, charities will improve the quality and quantity of collective goods and services in the countries in which they operate, if a deduction were allowed. The alternatives include not only increasing the tax benefits allocable to domestic charitable activities, but also increased government support for official development assistance (either directly or through grants to charities and other providers), multilateral organizations, or simply lower taxes.

It is likely that U.S. and foreign charities will act differently from governments or multilateral agencies.[162] To the extent that U.S. government aid policy is strongly influenced by foreign policy concerns, there is a greater role for tax subsidies for foreign charitable activities.

In examining the potential gains from increased tax benefits, I offer a few observations. First, the private sector may be more effective in providing certain types of goods and services than are U.S. government programs (either directly provided or funded and supervised by the United States Agency for International Development ("USAID")). Perhaps we subsidize charitable contributions not as a matter of tax policy, but rather as a means of achieving public goals.[163] Subsidized

expanded by relaxing limitations with respect to foreign-source income.

162. Raj M. Desai & Homi Kharas, *Do Philanthropic Citizens Behave Like Governments?* 1 (Wolfensohn Ctr. for Dev. at Brookings, Working Paper No. 12, 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1492214.

163. Schizer, *supra* note 41, at 255–58. While David Schizer's focus is primarily on the U.S. nonprofit sector, much of his discussion of recruiting nongovernment donors to monitor the quality of nonprofit organizations applies with equal or perhaps even greater force to foreign activities.

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charities represent one of many tools available to governments. We could then justify the charitable tax deduction in part because it provides incentives for donors to monitor the quality of nonprofit organizations. The Gates Foundation has substantial resources and financial and reputational incentives to monitor the activities of its health-care programs in Africa, and the benefits may be greater than those provided by similar U.S. government programs.[164]

Second, foreign charities may have advantages based on access to information, lower operating expenses due to proximity, and greater knowledge of local challenges than U.S.-based charities. Apart from compliance and enforcement concerns, tax subsidies should support those organizations that are the most efficient providers of goods and services. Expanding the pool of eligible recipients of tax-deductible contributions to foreign charities likely will yield additional benefits from the support of the development of a nonprofit sector in developing countries.

Third, private U.S. donors, domestic charities, and foreign charities may be better able to deal with political challenges as well as corruption issues in developing countries than can the U.S. government, World Bank, or other government or quasi-government providers. Charities operating in many countries face similar challenges due to political pressures or corrupt officials, but the consequences of confronting these pressures or corruption are very different for private actors than for government providers that may have a larger and more complex agenda in these countries.

2. Interaction with Other Providers

One consequence of increasing tax benefits for foreign charitable activities is that U.S. donors may play a greater role in foreign charitable activities. In the domestic context, the nonprofit sector can play a supplementary role, a complementary role, or an adversarial role with respect to the U.S. government.[165] This same framework could apply in the international environment, by expanding the frame of reference to include multiple governments as well as international institutions. Thus, for example, the interaction could be supplementary, whereby U.S. donors could fulfill directly (or provide additional support to foreign charities that fulfill) the demand for public goods that is not completely satisfied by the local government, other foreign governments, or other international institutions. The interaction could also be complementary in that U.S. donors could coordinate with other aid providers to increase

164. *See Global Health Program*, BILL & MELINDA GATES FOUND., http://www.gatesfoundation.org/global-health/Pages/overview.aspx (last visited Dec. 23, 2011).

165. Dennis R. Young, *Complementary, Supplementary, or Adversarial? Nonprofit-Government Relations*, *in* NONPROFIT & GOVERNMENT, *supra* note 18, at 37.

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the effectiveness of the assistance. The gains from decentralization of charitable activities are increased diversity and innovation. The cost is the lack of coordination either among other donors or with government agencies. Finally, the interaction could be adversarial in that U.S. donors could challenge either the policy of the U.S. or foreign governments or of international agencies. Nongovernmental organizations may face special challenges where their beliefs and preferences differ from those held by U.S. agencies or other providers of funding.[166] U.S. government or local governments could also try to influence the behavior of nonprofits through regulation or other institutional responses.

3. Substitution Away from Domestic Charities

While extending tax benefits to foreign charitable activities may increase total contributions from U.S. donors, these changes may result in substitution away from U.S. charities, particularly U.S. charities engaged in foreign activities. It is difficult to estimate the amount of substitution, but one would expect some substitution away from domestic to international activities. It is also difficult to measure whether there will be a substitution effect away from U.S. charities engaged in foreign activities to foreign charities.

IV. SHOULD THE TAX SYSTEM EXTEND TAX BENEFITS TO FOR-PROFIT ENTITIES ENGAGED IN CHARITABLE ACTIVITIES, INCLUDING FOREIGN FOR-PROFIT ENTITIES?

So far, this Article has addressed issues related to the domicile of the charitable organization, but it is also important to focus on the charity's corporate structure. Historically, tax law generally adopted a binary approach to for-profit and nonprofit organizations, with for-profit organizations subject to income tax and only nonprofit organizations qualifying for tax-exempt status and receiving tax-deductible contributions. In recent years, however, there has been a substantial increase in entities that blur the traditional boundaries between for-profit and nonprofit entities. Two trends are clear: nonprofit organizations are adopting more profit-oriented approaches, and some for-profit organizations are adopting charitable missions. Joint ventures between for-profit and nonprofit organizations are becoming more common and raise important governance and transparency issues.[167]

The label "for-profit charities" covers many different types of entities. Depending on the context, for-profit charities could include charities that look and operate a lot like for-profit entities, such as

166. Janelle A. Kerlin, *U.S.-Based International NGOs and Federal Government Foreign Assistance: Out of Alignment?*, *in* NONPROFIT & GOVERNMENT, *supra* note 18, at 373.

167. Sarah Dadush, *Profiting in (RED): The Need for Enhanced Transparency in Cause-Related Marketing*, 42 N.Y.U. J. INT'L L. & POL. 1269, 1312–19 (2010).

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hospitals, museums, and symphony orchestras, or the "related" activities such as universities operating bookstores, conference facilities, or basketball or football teams. It also could include the for-profit subsidiaries of tax-exempt entities. Particularly in the health-care field, it is common for nonprofit organizations to have for-profit subsidiaries and for nonprofit entities to convert to for-profit status.[168] Finally, there are for-profit companies that engage in activities that are similar to the charitable activities of tax-exempt charities.[169] It is this last type of entity that has been the subject of recent academic scholarship.[170]

Domestically, scholars have proposed allowing donors to make tax-deductible contributions to for-profit entities engaged in charitable activities and have considered alternatives for increasing the role of for-profit entities in charitable activities.[171] Should we, or can we, apply this analysis to the role of foreign charities?

A. Tax Benefits for For-Profit Charities

The most influential examination of charitable activities by for-profit entities is Anup Malani and Eric Posner's case for granting nonprofit charitable organization tax treatment to for-profit charities.[172] Ultimately, though, their conclusions assume a consistent rationale for the deductibility of charitable donations, and, as we have seen, that internal consistency may be lacking.[173] Like other scholars, Malani and Posner note that the level of desirable collective goods is less than socially optimal and that government subsidies may be necessary to increase the level of production of these desirable goods and services.[174] Malani and Posner argue that if our objective is to increase the level of these goods and services, then nonprofit organizations are not the only, or even the best, game in town.[175] As discussed below, similar arguments may support extending charitable deductions for foreign charities and, perhaps, other foreign organizations engaged in charitable activities.

Malani and Posner nicely frame the question as one of "linkage" or "coupling"—why is a particular tax benefit designed to promote

168. James J. Fishman, *Checkpoints on the Conversion Highway: Some Trouble Spots in the Conversion of Nonprofit Health Care Organizations to For-Profit Status*, 23 Iowa J. Corp. L. 701, 708 (1998).

169. Malani & Posner, *supra* note 30, at 2019–20; *see, e.g.*, Google.org, http://www.google.org/ (last visited Dec. 23, 2011) (website for Google, Inc.'s for-profit entity with philanthropic goals).

170. *E.g.*, Brian Galle, *Keep Charity Charitable*, 88 Tex. L. Rev. 1213 (2010); Hines et al., *supra* note 113; Malani & Posner, *supra* note 30.

171. Malani & Posner, *supra* note 30, at 2029–30.

172. *Id.* at 2019.

173. *See supra* notes 100–121 and accompanying text.

174. Malani & Posner, *supra* note 30, at 2030.

175. *Id.* at 2055 ("An underlying theme of this Essay is that nonprofit firms are less efficient than for-profit firms . . . .").

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charitable activities conditioned on a particular corporate form?[176] To answer that question, they examine several leading theories, two of which are discussed below, for why government support of charitable activities is necessary and desirable. They contend that decoupling would yield greater and more efficient production of these essential collective goods and services.[177] These gains would come from increased competition for charitable donations between for-profit and nonprofit charities, from improvement in operating efficiencies for nonprofit charities through better incentives for managers and incentives for minimizing costs, and from "economies of scope" achieved by allowing for-profit charities to achieve gains and scale efficiencies from the noncharitable activities of the organization.[178]

Malani and Posner begin with the "public good" theory for government support for voluntary contributions to increase the level of collective goods and services.[179] Their insight is that what is important is the end result (higher levels of collective goods and services), not the means of getting there (who actually provides the goods and services).[180] Allowing for-profit charities to receive tax-deductible contributions may also further the goal of decentralization of decisionmaking, as more and different entities will engage in the charitable activities.

Similarly, Malani and Posner respond to the "agency" theory that the nondistribution constraint for the nonprofit form provides comfort to donors that funds will be used exclusively for charitable purposes.[181] Malani and Posner consider the costs and benefits of imposing a nondistribution constraint.[182] They note that parties could use contract law to simulate the nondistribution constraint for all or part of profits from activities.[183] In addition, private parties could certify that for-profit charities comply with any nondistribution requirement.[184] They thus conclude that the agency theory does not provide an adequate basis for distinguishing between nonprofit and for-profit charities.[185]

Malani and Posner's call for tax subsidies for for-profit charities has drawn much criticism, on a variety of grounds. There are serious concerns at each step. Any efficiency gains made by virtue of for-profit

176. *Id.* at 2021. Bill Klein and I adopted a similar approach in questioning why limited-liability status and favorable tax regimes were linked to a particular corporate form. William A. Klein & Eric M. Zolt, *Business Form, Limited Liability, and Tax Regimes: Lurching Toward a Coherent Outcome?*, 66 U. COLO. L. REV. 1001, 1007 (1995).

177. Malani & Posner, *supra* note 30, at 2055.

178. *Id.* at 2027, 2056, 2063.

179. *Id.* at 2047–51.

180. *Id.* at 2049.

181. *Id.* at 2031–41.

182. *Id.*

183. *Id.* at 2036.

184. *Id.*

185. *Id.* at 2029.

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status would be undermined by the costs of monitoring and enforcement,[186] and decoupling tax subsidies from the nonprofit form creates new opportunities for tax arbitrage.[187] Particularly challenging is the application of the current vague criteria for eligible charitable activities of currently tax-exempt entities to for-profit entities engaging in a wide range of activities.[188]

I agree with most of these criticisms, but my take is different. I challenge the framing of Malani and Posner's argument. They make a persuasive case that existing theories (as well as their additional theories) do not provide adequate rationales for denying tax benefits to for-profit charities.[189] But where does this take us?

Here is one way to frame their argument: (1) The leading existing theories for allowing tax-deductible charitable contributions are *A, B*, and *C*; (2) theories *A*, *B*, and *C* do not distinguish based on for-profit and nonprofit forms of organization; (3) therefore, the leading theories do not provide a basis for distinguishing between for-profit and nonprofit charitable organizations; and (4) therefore, we should allow deductions for contributions made to for-profit charities.

I agree that existing theories of subsidizing charitable activities do not provide a clear basis for distinguishing tax-favored status based on form of organization. Accepting this failure, there are at least two possible outcomes. One, adopted by Malani and Posner, is that we should allow both nonprofit and for-profit organizations to qualify for tax subsidies as long as they are engaged in charitable activities.[190] This accepts 1 and 2 as true and provides support for conclusions 3 and 4.

But another conclusion is acknowledging that existing theories of subsidizing charities are inadequate. At one level this is not surprising. Existing theories are not particularly helpful in deciding which types of activities deserve charitable support or whether domestic altruism should rule over foreign altruism. So even though logically 1 and 2 are true and support the conclusion in 3, it does not necessarily follow that conclusion 4 is valid.

B. For-Profit Charities and Foreign Charitable Activities

Many similarities exist between providing charitable tax benefits to for-profit charities and providing charitable tax benefits to foreign charities. The gains are similar. Why constrain donors' choices? If the goal is to increase levels of underprovided goods and services, we should not limit the options available to those willing to fund these activities. By

186. Galle, *supra*, note 170, at 1233.
187. Hines et al., *supra* note 113, at 1214–15.
188. Schizer, *supra* note 41, at 254–55.
189. Malani & Posner, *supra* note 30, at 2029.
190. *Id.* at 2065.

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increasing the pool of potential providers of collective goods and services, we should increase both the quality and quantity of these goods and services. As discussed earlier, foreign charities may bring expertise and perspective to challenges in their countries that will be different and perhaps better than those provided by U.S. charities, even those U.S. charities that rely on local organizations to help design and administer their programs.

The challenges are also quite similar. Because of challenges in enforcement, it may be necessary to define more strictly the class of eligible activities (and perhaps eligible recipients).[191] There would be a trade-off between greater diversity in activities and a greater opportunity for abuse.

The for-profit charity debate provides an opportunity to think about alternatives to encourage charitable activity other than the current form of the charitable tax deduction. The charitable tax deduction is not the only tool for government to increase the role of the private sector in charitable activities. Other government programs or tax subsidies can increase private sector participation in charitable activities. These types of government subsidies avoid some of the challenges of extending tax deductibility for contributions to for-profit charities, but may invoke a different set of challenges and opportunities.

One alternative is to increase the level of government grants and contracts to for-profit firms to perform charitable activities. Since the 1970s, USAID, the government's foreign aid agency, has changed its approach from providing goods and services directly to using third-party contractors to provide foreign assistance.[192] These contractors are both for-profit and nonprofit organizations. To the extent that USAID is successful in monitoring contractors and evaluating performance, one would expect the more efficient providers to succeed, especially given the repeat nature of these contractual arrangements. These government grants and contracts could also provide direct support for foreign charities or for-profit groups or require U.S.-based providers to partner with local providers.

While this approach provides for monitoring activities of the for-profit providers, it also restricts the types of programs subsidized to those chosen by USAID or other government agencies. The distribution of government funds under this arrangement will reflect political and other priorities that may or may not match the set of charitable objectives preferred by society at large. In other areas, such as basic scientific

191. The current list of permitted charitable activities (as well as the regulatory regime) was adopted by Congress with an explicit "no private inurement" requirement. *See, e.g.*, Treas. Reg. § 1.501(c)(3)-(c)(2) (2010). It is interesting to think about what permitted activities and what regulatory regime would make sense if we allowed for-profit entities to qualify for charitable tax benefits.

192. Kerlin, *supra* note 166, at 375.

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research or the promotion of the arts, Congress has, with varying success, established quasi-independent boards to select and monitor recipients of government funds. Boards such as the National Science Foundation or the National Endowment for the Arts seek to provide funding to those organizations that will yield the greatest benefits (according to proposed mission) with, one hopes, minimal interference from the political process. One could imagine a similar board with responsibility for allocating funds to address issues tied to foreign charitable activities with the class of potential recipients broad enough to include foreign charities and for-profit firms, as well as domestic charities.

Finally, Congress has traditionally supported charitable activities by providing subsidies to the tax-exempt entities engaged in charitable activity. An alternative approach would provide tax subsidies to support *activities* rather than *entities*. For example, Congress could provide refundable targeted tax credits for specific activities related to foreign charitable activities. Targeted tax credits are used for a variety of purposes, including increasing research and development, development of orphan drugs, and alternative energy sources.[193] Similar tax credits could be designed to provide incentives for U.S. for-profit organizations to engage in specific types of charitable activities. Malani and Posner offer a variation of this approach, which combines targeted charitable activities and the charitable deduction.[194] Their plan would allow donors to make tax-deductible contributions for a particular charitable activity (but not to a charitable organization), but have the government choose the particular organization that would receive funding.[195] This alternative would provide policymakers with information about donor preferences without coupling the receipt of donated funds to nonprofit status.

CONCLUSION

This Article examines the tax regime governing charitable deductions for foreign assistance both to determine how the regime should be changed and also to see what insights might emerge on the desirability of using the tax system to subsidize charitable activities. The current tax regime generally allows U.S. taxpayers to deduct contributions to domestic charities with foreign activities but not to foreign charities and not to for-profit charities, including those engaged in charitable activities outside the U.S. These decisions cannot easily be reconciled. The challenges begin because of limitations in the basic theories justifying tax benefits for charitable activities. The challenges may be even greater when charitable assistance crosses national boundaries. Perhaps donors

193. I.R.C. §§ 41, 45C, 48C (2010).
194. Malani & Posner, *supra* note 30, at 2052.
195. *Id.*

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should not be allowed to decide without limitations how matching funds are provided for foreign charitable assistance. The donor-focused theories offer little or no guidance as to which charitable activities merit support, or whether to impose geographical limitations on either the use of the donation or the location of the charitable organization. Theories based on market failures may yield different conclusions depending on the type of charitable activity and the extent of market failure in a given geographical area. For those activities where most of the benefits accrue to foreign persons, perhaps the gains from a U.S. perspective of using the tax system to fund these activities are not worth the lost tax revenue. For theories based on political failures, it is not clear that the same considerations that allow donors to dictate in the domestic context apply to choices made with respect to foreign charitable activity. It may be that a different type of matching program that better targets federal funds to specific types of activities and to specific countries would yield a more effective and more representative subsidy program than that achieved under current tax law.

These theories justifying tax benefits for charitable activities are also flawed in their failure to address issues that arise in cross-border philanthropy. For example, the subsidy theories for charitable contributions assume a simple three-sector model of a government, a private sector, and a nonprofit sector and a single society in which voting, contributions, and subsidies take place. These theories do not reflect either the preferences of the recipient country or its citizens or the role of other multilateral institutions, foreign governments, bilateral aid agencies, and other foreign charities in providing assistance. It may be that there is an optimal amount of tax subsidy for foreign charitable activities, and that amount would vary over time given other programs' needs, government aid policies, and revenue constraints. But perhaps the government, and not private donors, should determine the level of public foreign assistance.

The question of the relative tax treatment of foreign charities and domestic charities may be the easiest to answer. If we want to continue to encourage foreign charitable activity, the objective should be to provide tax subsidies to those charities that could provide the highest quality goods and services at the lowest costs. It seems likely that for some types of activities, U.S.-based charities would have comparative advantages in providing these goods and services. But for other types of activities, such as disaster relief for victims of the Japanese earthquake, foreign charities likely have a better understanding of needs and challenges in their home countries, better access to information, and lower operating costs. In many cases, a combination approach may be best.[196] It is thus hard to

196. Recent efforts at reducing the costs and obligations of U.S. foundations in making grants to

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rationalize the current prohibition against tax deductions for direct contributions to foreign charities, for at least two reasons. First, the compliance and enforcement challenges of allowing deductions for contributions to foreign charities can be addressed by such measures as the IRS maintaining an "approved foreign charity" list or by adopting a "substantial equivalent" approach, whereby charities in those countries whose charitable regulations meet some minimum guidelines would qualify to receive tax-deductible contributions. Second, it is hard to justify such a prohibition and at the same time allow easy (but not costless) avoidance of the restrictions through either a "friends of" organization structure that allows several foreign charities access to U.S. tax subsidies or through donors establishing private foundations to direct foreign assistance.

Whether to extend tax benefits to for-profit entities engaged in charitable activities is a harder question to answer. Extending tax subsidies to for-profit charities presents many opportunities for gain or abuse similar to those presented by extending tax subsidies to foreign charities. Merely because several of the existing theories justifying the charitable deduction provide no clear basis for distinguishing between nonprofit and for-profit charities, it does not follow that a strong case exists for allowing tax deduction for contributions to for-profit charities. Nor do I believe that the similarities between foreign charities and for-profit charities mean that the policy responses are necessarily the same.

Finally, the challenges in designing a sensible regime for foreign charitable assistance highlight many of the weaknesses of the current charitable deduction regime applicable to domestic charitable activities. Two unrelated recent events bring the charitable deduction into greater focus: the billionaires' pledge, which will generate substantial funds for charitable activities, and the recent tax reform proposals that call for the repeal of many personal deductions and for changing the current tax regime for charitable contributions. At a general level, these events present squarely the "take it or leave it" approach to the charitable deduction. If we provide matching funds to support the billionaires' choices of which charities merit federal funds, we recognize the benefits and costs of the current regime and conclude that the benefits from the additional funds (as well as the benefits from engaging these donors in these charitable activities) outweigh the lost tax revenue and other costs that result from allowing donors to dictate how matching federal funds are spent. If we simply repeal the charitable deduction, we lose the incremental gains that result from the federal tax subsidy for charitable contributions and regain public control of public funds.

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foreign charities are helpful in providing charitable services and supporting these foreign charities. ADVISORY COMM. ON TAX EXEMPT & GOV'T ENTITIES, *supra* note 82, at 6.

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The "bang for the buck" approach may present a compromise to the extremes set forth above. It recognizes that the current regime for charitable deductions creates value, but perhaps not enough value for its costs, broadly defined. In thinking about changes to the current charitable deduction regime, many of the alternatives that arise in the context of designing government subsidies, including tax benefits, for foreign charitable assistance warrant examination not just abroad but in the domestic context as well. We should give serious consideration to narrowing the definition of charity for the purposes of the tax deduction (and perhaps for tax-exempt status), creating matching grant programs different than those inherent in the current charitable deduction, matching deductions for specific activities rather than entities, and designing better procedures for approving tax-exempt status and monitoring activities. Charity may begin at home—but perhaps clear thinking about it begins abroad.

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APPENDIX A: INDIVIDUALS SIGNING THE GIVING PLEDGE AND ESTIMATES OF CURRENT WEALTH[197]

Last Name(s)	**First Name(s)**	**Age(s)**	**Net Worth (in billions)**
Allen	Paul	58	$12.7
Arnold	Laura & John	37	$3.3
Berggruen	Nicolas	49	$2.2
Bloomberg	Michael	69	$18.0
Broad	Eli & Edythe	77 & 74	$5.8
Buffett	Warren	80	$45.0
Case	Jean & Steve	52 & 53	$1.1
Chan & Soon-Shiong	Michele & Patrick	59	$5.6
Cooperman	Lee & Toby	67	$1.5
Cummings	Joyce & Bill	*	*
Dalio	Ray & Barbara	62	$6.0
DeJoria	John Paul	67	$4.2
Diller & Von Furstenberg	Barry & Diane	69 & 64	$1.2
Doerr	Ann & John	59	$1.6
Ellison	Larry	66	$27.0
Feeney	Charles	*	*
Forstmann	Ted	71	$1.6
Frost	Phillip & Patricia	74	$2.3
Gates	Bill & Melinda	55 & 47	$54.0
Green	David & Barbara	69	$2.6
Greene	Jeff	56	$1.8
Hamm	Harold & Sue Ann	65	$8.6
Hill	Lyda	*	*
Hilton	Barron	83	$2.5
Huntsman	Jon & Karen	*	*
Icahn	Carl	75	$11.0
Jacobs	Joan & Irwin	77	$1.1
Kaiser	George	68	$9.4
Khosla	Vinod & Neeru	56	$1.4
Kimmel	Sidney	83	$1.1
Kinder	Rich & Nancy	66	$7.4
Langone	Elaine & Ken	75	$1.1
Lenfest	Gerry & Marguerite	*	*
Lokey	Lorry	*	*
Lucas	George	66	$3.3
MacMillan	Duncan & Nancy	*	*
Mann	Alfred	85	$1.2
Mansueto	Joe & Rika	54	$1.2
Marcus	Bernie & Billi	81	$1.5
Milken	Michael & Lori	64	$2.1

197. THE GIVING PLEDGE, http://www.thegivingpledge.org/#enter (last visited Dec. 23, 2011); *The World's Billionaires*, FORBES.COM (Mar. 9, 2011), http://www.forbes.com/wealth/billionaires/list.

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Last Name(s)	**First Name(s)**	**Age(s)**	**Net Worth (in billions)**
Mitchell	George	91	$2.0
Monaghan	Thomas	*	*
Morgridge	Tashia & John	77	$1.3
Moskovitz	Dustin	26	$1.4
Omidyar	Pierre & Pam	44	$5.5
Osher	Bernard & Barbro	*	*
Perelman	Ronald	68	$11.0
Peterson	Peter	84	$2.0
Pickens	T. Boone	82	$1.4
Robertson, Jr.	Julian	79	$2.2
Rockefeller	David	95	$2.2
Rose	Edward & Deedie	*	*
Rubenstein	David	61	$2.0
Sandler	Herb & Marion	*	*
Sanford	Denny	*	*
Sant	Vicki & Roger	*	*
Schusterman	Lynn	72	$2.0
Scott, Jr.	Walter	79	$1.9
Secunda	Tom & Cindy	56	$1.0
Simmons	Annette & Harold	80	$5.7
Simons	Jim & Marilyn	72	$8.7
Skoll	Jeff	*	*
Steyer & Taylor	Tom & Kat	*	*
Stowers	Jim & Virginia	*	*
Turner	Ted	72	$1.9
Weill	Sanford & Joan	*	*
White	Shelby	*	*
Zegar	Charles & Merryl	*	*
Zuckerberg	Mark	26	$6.9

* *indicates information not available*

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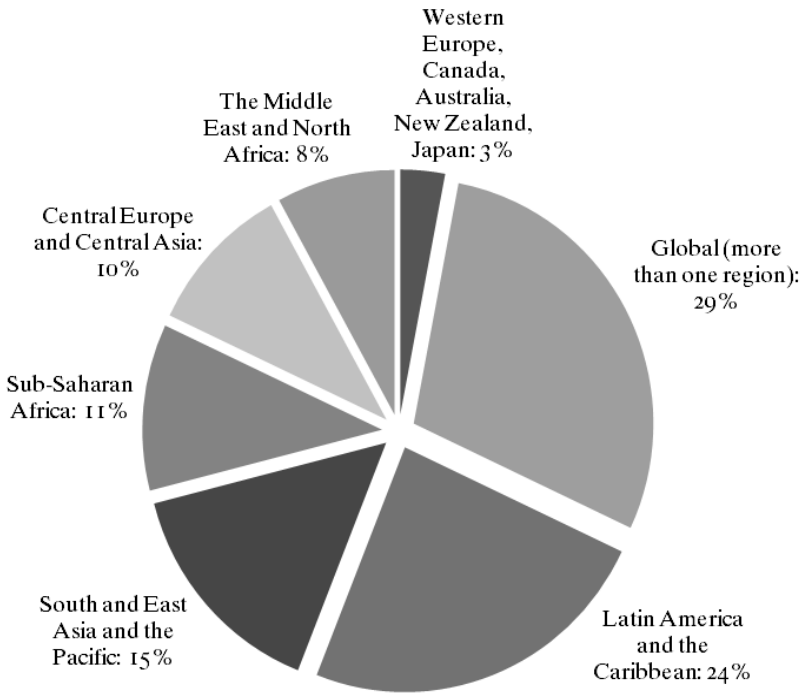
APPENDIX B: HOUSEHOLD GIVING BY SUBSECTOR OF INCOME AND CHARITY TYPE ($ IN BILLIONS)[198]

	Charity Type							
Household Income	**Religious**	**Combined**	**Help Meet Basic Needs**	**Health**	**Education**	**Arts**	**Other**	**Total**
<$100,000	59.96	7.70	9.34	3.06	2.69	1.01	6.16	89.92
$100,000 to $200,000	11.39	2.16	2.46	1.12	1.14	0.44	1.17	19.88
$200,000 to $1 million	21.01	10.19	5.30	4.81	29.15	13.57	7.45	91.48
$1 million or more	8.64	2.06	1.93	12.97	12.94	7.88	4.85	51.27
Total	101.00	22.11	19.03	21.96	45.92	22.90	19.63	252.55

198. CENTER ON PHILANTHROPY AT IND. U., *supra note* 53, at 12.

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APPENDIX C: DISTRIBUTION OF U.S. NONPROFIT CHARITABLE ASSISTANCE EFFORTS BY REGION[199]



Western Europe, Canada, Australia, New Zealand, Japan	3%
Global (more than one region)	29%
Latin America and the Caribbean	24%
South and East Asia and the Pacific	15%
Sub-Saharan Africa	11%
Central Europe and Central Asia	10%
The Middle East and North Africa	8%

199. Janelle A. Kerlin & Supaporn Thanasombat, *The International Charitable Nonprofit Subsector: Scope, Size, and Revenue*, NONPROFITS IN FOCUS, Sept. 2006, at 1, 5 (using 2003 data).

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APPENDIX D: TYPES OF FOREIGN CHARITABLE ACTIVITIES SUPPORTED BY U.S. NONPROFIT ORGANIZATIONS[200]

Type of Nonprofit	Number	% of total int'l nonprofits	Total revenue ($)	% of total revenue
International development and assistance				
General	866	15%	2,770,563,787	15.65%
Agricultural development	65	1%	202,131,615	1.14%
Economic development	200	4%	383,579,680	2.17%
International relief	1,200	21%	6,412,788,171	36.23%
Educational development	491	9%	791,543,584	4.47%
Health development	738	13%	2,455,202,841	13.87%
Science and technology development	53	1%	46,948,625	0.27%
Democracy and civil society development	93	2%	251,277,539	1.42%
Environment, population, and sustainability	209	4%	1,483,349,607	8.38%
Human rights, migration, and refugees	212	4%	941,816,849	5.32%
International development and assistance subtotal	4,127	74%	15,739,202,298	88.92%
International understanding				
General	342	6%	349,814,542	1.98%
International cultural exchange	120	2%	56,155,559	0.32%
International academic and student exchange	263	5%	561,544,247	3.17%
International exchanges N.E.C.	161	3%	136,662,235	0.77%
International understanding subtotal	886	16%	1,104,176,583	6.24%
International affairs				
General	165	3%	151,034,905	0.85%
Peace and arms control	205	4%	122,172,999	0.69%
International affairs education	103	2%	486,660,673	2.75%
National security	37	1%	44,019,940	0.25%
International economic and trade policy	75	1%	52,795,144	0.30%
International affairs subtotal	585	10%	856,683,661	4.84%
Total international nonprofits	5,598	100%	17,700,062,542	100.00%

200. *Id.* at 2 (using 2003 data).

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