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by Roger Colinvaux

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In this article, Colinvaux explains how Congress can advance the goals and values of philanthropy and address the crisis of the charitable sector.

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Philanthropy means to give for the benefit of others. Unfortunately for philanthropy and civil society, the laws supporting philanthropy are in a state of crisis. More by happenstance than design, the law now caters overwhelmingly to the whims of wealthy donors to the detriment of those in need. We find ourselves with a legal framework ostensibly designed to promote broad-based philanthropic activity, but which is better described as a framework where the wealthiest get tax benefits that are unavailable to others; claim those (sometimes questionable) benefits while retaining effective control over donated funds; and use the system to advance their policy preferences, avoid scrutiny, and undermine the centuries-old faith and trust that our nation's charities represent the public good. Although the trends are dire, Congress can take steps to broaden the base for charitable giving, improve the flow of money to working charities, strengthen oversight, and restore credibility to philanthropy.

Two Sides to Philanthropy

Meaningful philanthropy has two key aspects: a voluntary sacrifice (or gift) and a worthy cause. If someone is compelled to make a payment to

support even the noblest of causes, the payment is not a gift and would not be philanthropic. Likewise, gifts in support of a terrorist organization, even if voluntary, would fail as philanthropy because the cause falls outside mainstream ideas of what is worthy of support.

Federal law has long recognized and provided support for both these aspects of philanthropy. On the giving side, for over 100 years, the charitable deduction has encouraged giving by reducing its cost. If a dollar given to charity costs the donor only 63 cents (the current maximum subsidy), donors can afford to and will give more. On the worthy cause side, federal law defines a charity as being for specific purposes (for example, charitable, educational, religious, and scientific), and limits some types of activities (for example, no political campaigning). The rules are meant to define the outer boundaries of a worthy cause and ensure that charitable dollars are used for public good and not mainly to benefit donors or other private interests. Both planks of federal support for philanthropy, however, are at a breaking point.

A Broken Giving Incentive

Consider first the charitable deduction. Although it is widely credited with encouraging giving, it has also been criticized as a tax break for the wealthy that serves the policy preferences of vested interests through their control of the purse strings.¹ This criticism recently has taken on startling new force. The Tax Cuts and Jobs Act sliced by more than half the number of people

¹ Several recent books relay this theme. See Rob Reich, *Just Giving: Why Philanthropy Is Failing Democracy and How It Can Do Better* (2018) (discussing the ways in which philanthropy is a plutocratic voice); Anand Giridharadas, *Winners Take All: The Elite Charade of Changing the World* (2018) (describing philanthropy as "elite led, market-friendly, winner-safe social change"); and David Callahan, *The Givers: Money, Power, and Philanthropy in a New Gilded Age* (2018) (discussing the power wielded by wealthy philanthropists).

who will claim the deduction (an astonishing 21 million fewer people).² Thus, we have gone from a country where roughly 20 percent of taxpayers participated in the giving incentive to one where just the top 9 percent of taxpayers will receive a tax break for their gifts.³

Setting aside the effect this change will have on giving totals (one estimate puts the loss at \$17.2 billion),⁴ even more important is the impact a shrunken base of participation will have on the future of philanthropy. By providing a giving incentive for just the wealthiest, the policy signal is that the values of the charitable deduction — altruism, pluralism, civic participation — should be rewarded only when undertaken by the wealthy.⁵ It is ironic (and even insulting) that the federal government pays for more than one-third of the cost of gifts by the wealthiest 9 percent of taxpayers; but gifts by everyone else receive no subsidy. This disparity will solidify the giving incentive as just another tax planning tool for the elite and erode the pluralistic values that make our civil society a national asset.

The ultimate strength of the charitable incentive is in fostering diversity in the charitable sector through a wide range of individual support. The broader the base of that support, the more diverse, pluralistic, and independent the sector becomes. By shrinking the base of the charitable deduction to the top 9 percent (plus corporations!),⁶ the philanthropy that emerges will strongly reflect the philanthropic preferences of this elite group, meaning a nonprofit sector created by the better off in society, for their causes. Philanthropy will increasingly become a self-serving vanity project for one segment of society, and less worthy in a true philanthropic sense.

A Charitable Giving Credit

The solution is a giving incentive for all taxpayers. Legislation has been introduced in Congress that would provide a so-called universal deduction. The basic idea is simple and correct: Let everyone claim a charitable giving incentive. But in its current form the idea is more rhetorical than real. An unlimited, universal giving incentive would cost billions in taxpayer dollars, a very hard sell given that budget deficits are already closing in on \$1 trillion.

Further, an unlimited incentive would be wasteful and inefficient. A tax incentive should not reward all giving, much of which will occur regardless of tax breaks. A sensible approach would be to reward gifts exceeding a minimum amount (a floor) — this would encourage the extra giving that might not otherwise occur and reduce the revenue and administrative costs of an expanded incentive. In short, an incentive for all taxpayers triggered by a minimum amount of giving could increase giving, broaden the base of participation, and need not cost the sun and the moon.

But charitable giving policy should not stop there. Simply to open the existing door wider is to ignore festering problems inside that should be fixed. One issue that has long dogged the charitable deduction is that it provides different rewards based on income level, with the wealthier getting more. Under the deduction, if a taxpayer makes a \$1,000 gift, the amount of the tax break varies widely. The subsidy could be \$370, \$320, \$220, \$120, or \$0, depending on which tax bracket the taxpayer is in and whether the taxpayer itemizes deductions. This is unfair. Further, the amount of the tax break changes as tax rates change, making giving more expensive when rates go down and cheaper when rates go up, regardless of the amount that would generate the most giving. Rather than this inequitable, ad hoc system, it would make more sense to provide a uniform benefit, say 25 percent of the gift. A fixed amount would be fairer and more transparent to taxpayers, which in turn could result in greater giving at less cost.

This could be accomplished by replacing the deduction with a credit. A tax credit for the charitable giving of all taxpayers, subject to a floor, would be a bold step toward fairness,

² Joseph Rosenberg and C. Eugene Steuerle, "Reforming Charitable Tax Incentives: Assessing Evidence and Policy Options," Tax Policy Center (Nov. 15, 2018).

³ *Id.*

⁴ Alex Brill and Derrick Choe, "Charitable Giving and the Tax Cuts and Jobs Act," American Enterprise Institute (June 2018).

⁵ See Roger Colinvaux, "The Importance of a Participatory Charitable Giving Incentive," *Tax Notes*, Jan. 30, 2017, p. 605.

⁶ Christopher Ingraham, "Massive New Study Traces How Corporations Use Charitable Donations to Tilt Regulations in Their Favor," *The Washington Post*, Jan. 17, 2019.

transparency, and efficiency. It would unleash charitable giving to reflect the interests of the American people, not simply those with the most resources.

To address concerns that a floor might wipe out the incentive for many middle-income donors, there could be different floors depending on income level. For example, for high-income taxpayers, a floor as a percentage of the taxpayer's adjusted gross income (say 2 percent) might make sense. For lower-income taxpayers, a lower percentage or even a dollar-based floor should be considered.⁷ The objective would be to set the floor at an amount that would be transparent and not so high as to reward only extraordinary giving levels.

Reform In-Kind Giving

Another important if less well-known issue lawmakers should address is in-kind giving (that is, gifts of property). In-kind giving is a billion-dollar industry. In 2015, for example, in-kind contributions were about \$64 billion, or nearly one-third of the amount of all contributions.⁸ Indeed, some charities are set up substantially to solicit and then sell property contributions and distribute the proceeds.⁹ Right now, taxpayers can give almost anything to charity (interests in a private company, jewelry, a stuffed game trophy, or cryptocurrency, for example) and receive a deduction for the full appraised value, even if the value later plunges, the charity incurs significant costs to maintain or sell the property, or the charity does not want the property but accepts it to avoid antagonizing a donor (or even to facilitate tax abuse). Unfortunately, many property gifts cheat the government because the deduction is based on the appraised value (which may have to be litigated), not the amount made available after sale. Further, the deduction for in-kind giving is an extra boon for the wealthy

⁷ A dollar-based floor or floors (for example, only gifts exceeding \$500 get the benefit) would be transparent to taxpayers, who would know at the start of each year exactly when the incentive would begin.

⁸ IRS, "Individual Noncash Charitable Contributions, Tax Year 2015."

⁹ Fidelity Charitable, for example, in 2015 reported receiving \$2.95 billion in noncash contributions. See generally David Gelles, "How Tech Billionaires Hack Their Taxes With a Philanthropic Loophole," *The New York Times*, Aug. 3, 2018 (discussing ways that donors use donor-advised funds (DAFs) for in-kind property contributions).

because the law permits donors to deduct untaxed appreciation and avoid capital gains tax.¹⁰

Assuming that policymakers are not ready to limit the charitable giving incentive to cash gifts only¹¹ or to limit the ability to deduct untaxed gains,¹² another option would be to better align the giving incentive with the public benefit provided by the gift. Instead of basing the tax benefit on the appraised value of donated property, the benefit should be based on the amount made available after sale.¹³ Doing so would at least make certain that scarce taxpayer dollars are not being used to subsidize gifts of questionable value and that the subsidy matches the net amount that working charities receive.¹⁴

Making Philanthropy Work for Philanthropy

Fixing the charitable giving incentive to make it fairer, more widely available, and less prone to abuse would be a huge improvement, but that would address only part of the problem facing philanthropy.

The other part is that the boundaries that have long been designed to keep excessive private influence out of the charitable sphere are under constant strain and attack. The combination of open-ended legal standards, weak enforcement, partisan pressure, and the rise of new giving vehicles have all contributed to a weakening of the "worthy cause" side of philanthropy. The philanthropic scale is becoming tilted in favor of donors and private interests, to the detriment of the causes that philanthropy is meant to serve.

¹⁰ See Calvin H. Johnson, "Ain't Charity: Disallowing Deductions for Kept Resources," *Tax Notes*, Aug. 2, 2010, p. 545.

¹¹ For additional discussion, see Colinvaux, "Charitable Contributions of Property: A Broken System Reimagined," 50 *Harv. J. on Legis.* 263 (2013).

¹² See Colinvaux, "Donor Advised Funds: Charitable Spending Vehicles for 21st Century Philanthropy," 92 *Wash. Law Rev.* 39 (2017) (arguing that if the deduction for in-kind giving is retained, the tax benefit be limited to the lesser of the net benefit to charity from the gift or the donor's tax basis plus one-half of the untaxed appreciation).

¹³ This is the approach that applies to car donations. See section 170(f)(12).

¹⁴ If noncash gifts are allowed as part of any expansion of the giving incentive, it is natural to expect the many problems associated with in-kind giving to multiply, making the need for reform even more pressing. One approach might be to keep the current itemized deduction largely intact (but with a new floor) while allowing a non-itemizer, cash-only credit — subject to a floor (or floors). Such an approach would, however, retain the inequity of current law by providing greater benefits to wealthier donors.

Limit Donor Control and Improve Transparency

The problems here are so varied that a neat summary is impossible. To start, however, one critical area for common-sense solutions reflects the phenomenal rise of a new giving vehicle — the donor-advised fund (DAF). DAFs are financial accounts managed by a sponsor (like Fidelity Charitable, Schwab Charitable, or Vanguard Charitable). A donor contributes to the sponsor (in cash or property) and takes a tax deduction, and the sponsor opens an account in the donor's name. The donor then decides when to distribute money from the account to a charity. Money in DAFs can remain there indefinitely because there is no requirement that DAF contributions be spent at any specific time. DAFs resemble charitable checking accounts — the donor gets the tax benefit immediately but writes the check later, if ever.

DAFs matter because they now dominate charitable fundraising, representing roughly 10 percent of gifts. In 2017 Fidelity Charitable was the No. 1 charity in the United States, raising \$6.83 billion, more than twice as much as the United Way.¹⁵ Altogether, the top four DAF sponsors raised more in 2017 than the top 10 working charities — that is, active groups like the Salvation Army — combined.¹⁶ In short, billions of dollars are going to conduit charities each year, waiting to be put to use at the donor's say-so, but after the donor has already taken a tax deduction. Notably, recent tax law changes will help ensure that DAFs' share of the giving pie will continue to grow because donors now have incentives to bunch several years of contributions into one year to get a deduction for their gifts.¹⁷

Although the DAF structure is legal, at bottom DAFs give donors too much power to decide when to make distributions. The payout rate — or the rate of spending from DAF accounts — is often touted as a sign of health in the DAF industry. This is because aggregate payout rates

are high when compared with private foundations. The National Philanthropic Trust, for example, reports a payout rate for 2017 of 22.1 percent across all DAFs, with a similar rate for prior years.¹⁸ There is, however, no agreed method for determining payout rate. If the denominator of the payout ratio is changed from prior year asset value (which the National Philanthropic Trust uses) to payout year asset value plus grants (which reflects current year contributions) the payout rate for 2017 drops substantially from 22.1 percent to 14.9 percent.

Further, one major limitation in the data is that it is collected on an aggregate basis, not an account basis, meaning that all payout calculations are averages. So even if a DAF sponsor boasts a payout rate of 20 percent, this could mean that for every one DAF account that pays out all contributions in the year of the contribution (a 100 percent payout rate) there are four DAF accounts that pay nothing. In other words, average payout rates reflect a wide array of high and low payout rates per fund. One researcher, for example, estimates that in 2012, over a quarter of DAF organizations had roughly a 4 percent payout rate with “466 organizations that reported no grants paid out at all.”¹⁹

Also, there are built-in constraints that can deter spending the money invested in DAF accounts. When DAF sponsors (or affiliated entities) earn fees based on amounts under management,²⁰ they have a financial incentive to retain funds. When this is combined with the human tendency to procrastinate on tough decisions and to save for the future, there is reason to be concerned that the institutional default of the DAF industry is toward accumulating, not spending.²¹ Moreover, even when money goes out of a DAF relatively quickly

¹⁵ Drew Lindsay, “America’s Favorite Charities 2018,” *Chron. of Phil.* (Oct. 30, 2018).

¹⁶ *Id.*

¹⁷ As discussed above, the increase in the standard deduction means that many taxpayers will not ordinarily spend enough in a given year to get a tax benefit for charitable gifts. As a response, many taxpayers are likely to defer their giving and bunch many years’ worth of gifts together into one year to exceed the standard deduction and obtain a tax benefit.

¹⁸ See National Philanthropic Trust, *2018 Donor Advised Fund Report* 18.

¹⁹ Paul Arnsberger, “Donor-Advised Funds: An Overview Using IRS Data,” Boston College Law School Forum on Philanthropy and the Public Good (Oct. 2015).

²⁰ See Alan M. Cantor, “Donor-Advised Funds and the Shifting Charitable Landscape: Why Congress Must Respond,” 134-136 (unpublished manuscript).

²¹ See James Andreoni, “Who Benefits From Donor Advised Funds? Insights From Behavioral Economics,” University of California, San Diego working paper (May 2016) (discussing the endowment and other effects from behavioral economics as giving “the donor the incentive to wait before spending the money from the DAF”).

(say within four years of the initial contribution), there is a social cost to the delay because that money cannot be put to active use. The longer that money sits unused in a DAF, the longer that urgent needs of working charities and those they serve go unmet.

The purpose of these accounts is, or should be, to raise and promptly distribute money for charity, not to become foundations of wealth for future generations to spend.²² And yet DAFs are becoming a form of institutionalized deferral of charitable activity without any input or discussion from Congress as to their appropriate role. Congress should carefully consider whether DAFs are serving the public interest and the philanthropic sector as a whole. Are charities and their beneficiaries better off from having enormous sums of money pass through a financial intermediary? Do DAFs actually increase charitable giving in substantial enough amounts to justify their costs?²³ At a minimum, Congress should weigh whether to impose a requirement that all DAF contributions be put to use within a reasonable time, say five to seven years.²⁴ A reasonable spending rule would not disrupt the ease of giving and convenience of DAFs, and working charities would have a reliable and steady influx of needed cash, from all DAFs.²⁵

²² See Drummond Pike, "How I Helped Create the Donor-Advised Fund Monster — Inadvertently," *Chron. of Phil.* (Aug. 22, 2018) (describing how DAFs are essentially "mini-private foundations").

²³ See Andreoni, "The Benefits and Costs of Donor-Advised Funds" in *32 Tax Policy and the Economy* (2018) (arguing that to be cost-effective, DAFs should in the aggregate generate in the range of 16 to 30 percent of new charitable giving, but there is "little evidence that DAFs are encouraging significantly more giving over a policy of no DAFs"). Andreoni points out that a main use of DAFs is to avoid capital gains tax on appreciated assets, which can cost new revenue loss without any new charitable giving. For example, with DAFs, a donor has a strong tax incentive to give appreciated property instead of cash to wash out the capital gain and use the cash to repurchase the asset.

²⁴ See, e.g., Chuck Collins, Helen Flanner, and Josh Hoxie, "Report: Warehousing Wealth: Donor Advised Charity Funds Sequestering Billions in the Face of Growing Inequality," *Inst. Pol'y Studies* (July 25, 2018); and Ray Madoff, "Three Simple Steps to Protect Charities and American Taxpayers From the Rise of Donor-Advised Funds," *Nonprofit Q.* (July 25, 2018).

²⁵ Not all DAF sponsors are the same. The largest have commercially affiliated sponsors (such as Fidelity, Schwab, and Vanguard). Others are housed within community foundations or operating charities (such as a university). One issue for Congress to address is the extent to which the type of DAF sponsor is relevant in determining any spending rule. See Colinvaux, "Defending Place-Based Philanthropy by Defining the Community Foundation," *2018 BYU L. Rev.* 1 (2018) (discussing the extent to which community foundations are distinguishable from commercial DAF sponsors).

There is also a darker side to DAFs. The very flow-through nature of a DAF means that it can be used to launder money and avoid transparency in charitable giving.²⁶ A focus here are private foundations, which typically are set up by wealthy founders or families. Because of the inherent possibilities for abuse through family control of the foundation, Congress 50 years ago established a separate legal regime for foundations to ensure that the assets are used for public good. For example, foundations must publicly disclose their major donors so the public can trace foundation funds. But if a foundation pays to a DAF, and then advises a payment from the DAF, disclosure and accountability are avoided. Thus, if a right- or left-leaning foundation wants to back a cause without telling people, it can hide behind a DAF intermediary.²⁷

Relatedly, foundations can also use a DAF to avoid their legal obligation to spend a minimum amount on charity each year. Foundations commonly make grants to DAFs,²⁸ which technically counts as spending, even though the foundation retains advisory privileges and does not ever have to distribute the money from the DAF. Foundation-to-DAF grants are yet another way that money can remain under effective control of the donor without getting to working charities.

There is an easy fix to these loopholes. Private foundations either should not be allowed to count distributions to DAFs as spending, or must spend any such distributions quickly and, in any event, with full flow-through disclosure.

²⁶ Alana Semuels, "The 'Black Hole' That Sucks Up Silicon Valley's Money," *The Atlantic*, May 14, 2018.

²⁷ See, e.g., Jane Mayer, *Dark Money: The Hidden History of the Billionaires Behind the Rise of the Radical Right* 205-207 (2016) (describing private foundations' use of DAFs to fund a policy campaign against climate science); and Robert O'Harrow Jr., "Project Veritas Received \$1.7 Million Last Year From Charity Associated With the Koch Brothers," *The Washington Post*, Dec. 2, 2017 (describing the Koch Foundation's use of a DAF).

²⁸ See Mark Harris, "How Elon Musk's Secretive Foundation Hands Out His Billions," *The Guardian*, Jan. 23, 2019 (describing a \$37.8 million gift from the Musk Foundation to Vanguard Charitable in a year when the foundation's payout was high); "A Philanthropic Boom: 'Donor-Advised Funds,'" *The Economist*, Mar. 23, 2017 (noting that in a random sample of foundations, some gave more than 90 percent of their money to DAFs).

Problems of Enforcement and Administration

So far, the problems discussed that plague the charitable sector are concrete enough to allow for fairly straightforward solutions, assuming there is political will to act. More difficult to tackle are problems of enforcement and administration. There are more than 1.3 million charities, with tens of thousands of new ones formed every year (nearly 80,000 in 2017).²⁹ To address a backlog in applications for charitable status, the IRS in 2014 introduced a short form application, the Form 1023-EZ, which has so streamlined the process that small new charities can easily form with little understanding of their legal obligations, and bad actors can just as easily use the short form to game the system.³⁰ Further, there are hundreds of thousands of other nonprofits, which include social welfare groups like the NRA, the ACLU, and AARP. The division of the IRS charged with oversight has seen its budget slashed and has been under attack for more than five years for its bungled attempt at overseeing the political activity of nonprofit groups.³¹ Perhaps unsurprisingly, the audit rate for charities is infinitesimally low. The IRS reports that tax-exempt organizations filed 1,528,487 returns in 2017 (including the Form 990 series and other returns) and that of these, about 3,678 were audited, for an audit rate of 0.24 percent, or one-quarter of 1 percent.³²

And even if the IRS was looking, legal violations are not always clear and are easy to

disguise. Here is an archetype of possible abuse. A wealthy individual sets up a “charity,” and funds the group with tax-deductible contributions (perhaps even from the founder’s DAF to get around being classified as a private foundation). The founder sits on the board and hires his son to be CEO, paying him handsome compensation, for which the son “manages” the money. If the founder is politically motivated, the charity might grant charitable funds to a dark money group, ostensibly for “social welfare” purposes, that uses the money to intervene in political campaigns. The charity might also hold and manage private business interests of the founder (for which the founder took a deduction), make loans to family members that are never paid back, or contract with the founder’s company. If these scenes sound familiar, it is because one or another variant of them has been featured in unfavorable news reports about charities.

A well-publicized recent illustration involves a charity called Foundation for Accountability and Civic Trust (FACT). FACT employed Matthew Whitaker before his appointment as acting attorney general. FACT’s stated mission is to work for accountability and ethics in government. Public filings show that from its founding in 2014 through 2017, FACT received virtually all of its funding from Donors Trust, a section 501(c)(3) organization and a sponsor of DAFs. If the donations had come directly from one individual instead of through a DAF, FACT would have been classified as a private foundation and subject to tougher rules. Overall, donations from Donors Trust were \$3,450,000, of which \$1,219,000 was paid to Whitaker as salary (for 39 months’ work). The rest was paid to a handful of private entities, one of which had the mission of defeating Democrats.³³ Importantly, this apparent misuse of section 501(c)(3) can be by actors on the political right or left.³⁴

Some of the problems of private benefit and influence over charities are endemic to the system. The law has always allowed charities to form

²⁹ For example, the IRS reports that in 2017, 79,699 new charities (section 501(c)(3) organizations) were approved while 68 were disapproved. IRS, Table 24a, “Closures of Applications for Tax-Exempt Status, by Organization Type and Internal Revenue Code Section, Fiscal Year 2017.”

³⁰ The Taxpayer Advocate Service lists this new form as one of the most serious problems in tax administration. See TAS, “Annual Report to Congress 2017, Most Serious Problems Encountered by Taxpayers, Exempt Organizations: Form 1023-EZ, Adopted to Reduce Form 1023 Processing Times, Increasingly Results in Tax Exempt Status for Unqualified Organizations, While Form 1023 Processing Times Increase,” vol. 1, at 64 (2017).

³¹ See, e.g., Alan Rappeport, “In Targeting Political Groups, I.R.S. Crossed Party Lines,” *The New York Times*, Oct. 5, 2017.

³² This number is not exact because the returns filed include one form (Form 8872) not reflected in the audit figure and the audit figure includes two forms (forms 1041-A and 1120-POL) not reflected in the return figure. See IRS, “Returns Filed, Taxes Collected & Refunds Issued,” at Table 2, “Number of Returns and Other Forms Filed, by Type, Fiscal Years 2016 and 2017”; and IRS, “Enforcement: Examinations,” at Table 13, “Returns of Tax-Exempt Organizations, Employee Retirement Plans, Government Entities, and Tax-Exempt Bonds Examined, by Type of Return, Fiscal Year 2017.”

³³ See O’Harrow, Shawn Boburg, and Aaron C. Davis, “Conservative Nonprofit With Obscure Roots and Undisclosed Funders Paid Matthew Whitaker \$1.2 Million,” *The Washington Post*, Nov. 20, 2018.

³⁴ Treasury is considering rules to address the use of DAFs to avoid private foundation treatment. See Notice 2017-73, 2017-51 IRB 562.

based on their purposes, which can be very broad. Keeping the criteria for worthy causes broad helps to ensure pluralism within the sector and avoids the IRS having to make politically charged and substantive determinations of what is in the public interest. But a porous border also means that bad actors can abuse the charitable form, and that groups that are more about propaganda than education — and business rather than charity — can operate under a charitable guise.³⁵

While there is no easy answer, Congress can do some things that could help. One is to leave alone the rule that prohibits charities from getting involved in political campaigns. To allow the repeal or weakening of this rule (lately called the Johnson Amendment) would be devastating to the independence of the sector from partisan money flows.³⁶ Part of what makes philanthropy work is our collective belief that on balance, charitable organizations are not self-serving or partisan. If charities are allowed to campaign in elections, this basic belief will be shattered, and we will all be worse off.

Some strongly believe that endorsing candidates in elections is central to the mission of some charities, particularly evangelical churches. This may be a sincerely held view, but it should not dictate the norms of the entire charitable sector. If possible, Congress should try to find a way to accommodate the concerns of this minority of charitable organizations, without adopting a rule that undermines the integrity of the charitable sector or that further involves the IRS in regulating campaign activity, as last year's (and now this year's) proposed legislation would have done.³⁷

Congress could also take steps to improve enforcement outcomes. One simple and cost-effective measure would be to require the electronic filing of the information returns (Form 990s) that charities and other nonprofits must file. Electronic filing would enhance oversight of the

sector because this public information would become available on a more timely basis and would be much easier to access and administer — by the public, the news media, and the IRS.³⁸

Further, Congress could show support for the oversight function of the IRS regarding nonprofits, with more funding and less partisan posturing. Political support from the taxwriting committees in Congress would help IRS efforts to protect charitable assets from private corruption and deter bad actors. And if Congress is unwilling to be a constructive partner in the enforcement challenges the IRS faces, it should convene a panel to study whether oversight responsibilities should be taken out of the IRS altogether. The IRS is primarily a revenue collection agency, not a nonprofit regulator.³⁹ This means that when it comes to tax-exempt organizations, the IRS has few incentives to enforce the law and significant challenges in doing so, which as recent history has shown can lead to a national political firestorm.⁴⁰

Better Legislation

Congress also needs to get smart. In the TCJA, Congress cited the importance of a robust charitable sector, but at the same time passed provisions that seem wrong, overbroad, or not thought through (or all three), and that add indescribably high compliance costs to groups that are unequipped to cope (nor should they have to).

³⁸ See, e.g., Government Accountability Office, "Tax-Exempt Organizations: Better Compliance Indicators and Data, and More Collaboration With State Regulators Would Strengthen Oversight of Charitable Organizations," GAO-15-164, at 41 (Dec. 2014) (concluding that expanded e-filing could result in "more accurate and complete data becoming available in a timelier manner" and would permit outside stakeholders with more and better information to "improv[e] transparency and accountability.").

³⁹ For a discussion of IRS oversight of the tax-exempt sector, see Evelyn Brody and Marcus Owens, "Exile to Main Street: The IRS's Diminished Role in Overseeing Tax-Exempt Organizations," 91 *Chi.-Kent L. Rev.* 859; and Lloyd Hitoshi Mayer, "The Better Part of Valour Is Discretion: Should the IRS Change or Surrender Its Oversight of Charitable Organizations?" 7 *Col. J. Tax L.* 80 (2016).

⁴⁰ Joe Davidson, "IRS Chief Departs, Blasting Congress for Budget Cuts Threatening Tax Agency," *The Washington Post*, Nov. 7, 2017 (Commissioner John Koskinen had repeatedly warned Congress about the dangers of shortchanging the agency. . . . But Republicans were intent on penalizing the IRS because they said it had improperly scrutinized right-leaning organizations.); Andy Kroll, "How the IRS Chief Went From Respectful Public Servant to Political Punching Bag," *The Washington Post*, Mar. 2, 2017.

³⁵ Katie Thomas, "Drug Maker Pays \$360 Million to Settle Investigation Into Charity Kickbacks," *The New York Times*, Dec. 6, 2018.

³⁶ National Council of Nonprofits, "Community Letter in Support of Nonpartisanship" (Sept. 5, 2017); Letter to Congress by 103 Religious Leaders Opposing Politicization of Houses of Worship (Nov. 13, 2017).

³⁷ See Colinvaux, "The House Tax Bill Could Be the End of Charities as We Know Them," *Chron. of Phil.* (Nov. 16, 2017) (discussing the Free Speech Fairness Act).

The leading example is a tax on nonprofits for providing free parking to employees.⁴¹ Congress said the tax would “make the tax system simpler and fairer for all businesses.”⁴² The fairness rationale presumably comes from the fact that elsewhere in the act, Congress removed the deduction that for-profit businesses get for providing free parking. But “fair” or equal treatment between a nonprofit when performing its nonprofit functions and a for-profit business makes no sense. There is not meant to be a level playing field, which is why nonprofits get tax exemptions in the first place.⁴³ The result is that now every nonprofit (including churches, which have been vocal in their opposition) that provides free or discounted parking to employees must determine the cost of the parking and perhaps file a tax return for the first time.⁴⁴ This provision is a mistake and should be promptly repealed before any more time is wasted by nonprofits and the IRS in implementation.

A slightly less egregious example of poor legislating relates to the unrelated business income tax, which is a tax on the for-profit activities of nonprofits (a true “leveling the playing field” tax). Ironically, here, Congress has now adopted a rule that treats nonprofits worse than for-profit businesses.⁴⁵ For-profits generally may aggregate income and expenses across different trades or businesses. Until the TCJA, nonprofits were treated similarly regarding their unrelated business income. But now the code says that nonprofits must calculate the net income or loss from each business separately (called siloing) and may not measure their aggregate business income or loss. Not only is this an unfair way to measure income, but it treats nonprofits worse than for-profits, which runs against the level

playing field rationale Congress seemed to care about in other provisions. Further, the new approach is incredibly complicated because nonprofits now must determine how to classify distinct trades or businesses, which no one knows how to do.⁴⁶

The reasoning for the new UBIT approach has its roots in a 2013 IRS study.⁴⁷ This study, however, pertained to only one segment of the nonprofit sector — an audit sample of 34 colleges and universities. Yet the siloing provision applies not only to every section 501(c)(3) organization (not just colleges and universities), but also to all other nonprofits, including social welfare groups, labor unions, and trade associations. More importantly, the main problem that the IRS identified in the study was the improper allocation of expenses and losses from nonprofit business to for-profit businesses, which was already prohibited (resulting in the IRS adjusting the income of the audited group). In short, the new siloing approach is a vastly overbroad remedy to an issue of unknown scope that imposes highly significant compliance costs on the nonprofit sector. Congress should repeal this and return to the drawing board.

Setting aside the wisdom of the parking tax and the UBIT siloing rule, the broader point is that increasing the compliance burden on nonprofits and charging the IRS with enforcement of unclear provisions is not the best use of nonprofit or government resources.⁴⁸ These provisions were rushed through, and perhaps the need to repeal them can serve as an opportunity for serious consideration of issues that do need legislative attention. Congress can do better; the nonprofit sector deserves better.

⁴¹ Section 512(a)(7).

⁴² H.R. Rep. No. 115-409, at 266.

⁴³ The way the provision was drafted is nonsense. The tax is imposed as a tax on “unrelated business income,” but the tax applies only to the *related* parking activity of the nonprofit and not to unrelated business parking activity. In other words, the provision purports to impose a tax on related, charitable activity by deeming it an unrelated business activity. That makes sense only in a world where up is down and left is right. Sadly, this is an assault on rational lawmaking.

⁴⁴ Notice 2018-99, 2018-52 IRB 1067 (providing “interim guidance for taxpayers to determine the amount of parking expenses for qualified transportation fringes”). A glancing read of the notice quickly undermines Congress’s simplicity rationale for the tax.

⁴⁵ Section 512(a)(6).

⁴⁶ See Notice 2018-67, 2018-36 IRB 409 (36 pages providing interim guidance on the siloing provision).

⁴⁷ IRS, “Colleges and Universities Compliance Project Final Report” (May 2, 2013) (selecting 34 of 400 colleges and universities for exam based on responses to a questionnaire).

⁴⁸ Other provisions in the TCJA impose high compliance costs without a clear rationale and, even if directed to a valid policy concern, should be revisited. The new excise tax on excess compensation, for example, sends a strong political message that salaries at nonprofits should not exceed \$1 million (even if the compensation is reasonable), but there are existing provisions that address excess compensation that could have been strengthened in lieu of this new tax, which has remarkably complex implications. See Notice 2019-9 (92 pages of interim guidance).

Time to Act

The charitable sector is at the edge of crisis. Fortunately, there are steps Congress can take: strengthen the giving incentive by making it available to more people within sensible limits; eliminate waste in the deduction for in-kind contributions; unlock the money available for distribution to working charities with a reasonable spending rule for DAF contributions; and improve transparency and foster more spending from private foundations by limiting foundation-to-DAF transfers. Congress can also strengthen the worthiness of the charitable sector by retaining the historic separation of politics from charity; mandating the electronic filing of information returns; providing adequate funding for oversight; and revisiting the rushed-through ideas in the TCJA.

The approaches outlined here will not solve all the problems, and other ideas should be explored, but it is critically important that policymakers and stakeholders in the nonprofit sector look beyond their own interests and commit to take steps to improve both the giving and worthy cause sides of philanthropy.

A healthy and vibrant charitable sector is in the national interest and should be an area where common-sense solutions can be reached. Perhaps in the 116th Congress, our leaders will come together and take the steps necessary to make philanthropy work, for all Americans. ■

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