COMMON CHARACTERISTICS IN TAX LITIGATION
AFFECTING NONPROFITS:
CLUES TO FUNDAMENTAL RESPONSES TO
LEGAL AND ETHICAL CRISIS

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ABSTRACT

There is general agreement in the nonprofit literature that the nonprofit sector is in a state of legal and ethical crisis. The numerous ethical breaches reported in the press are indicative of significant problems; problems having wide-reaching public policy implications.

These ethical problems are leading to greater governmental scrutiny and intervention. Thus, nonprofits need to identify opportunities for improvements in tax policy, management and governance to prevent such intervention from adversely affecting service delivery. In order to identify appropriate responses, historical data about nonprofit behavior is needed.

Analysis of tax litigation affecting nonprofits over the past 40 years provides substantial data about behavior patterns and suggests possible responses. This study enhances our understanding of the legal and ethical implications of management decisions and surfaces what public policy (tax policy) initiatives, enforcement mechanisms or professional standards might be most effective in dealing with illegal behaviors.

This study adds to the growing body of research on nonprofit management and governance by providing a typology of illegal behaviors evidenced in the case law and a comparison of behavior patterns to the existing policy
and legislation. It was hypothesized that the present exemption statutes and other legal, theoretical, professional and public policy criteria were insufficient to adequately prevent or punish certain illegal and unethical behaviors.

An analysis of every exemption case decided in the last 40 years provided substantial information about illegal and unethical behaviors. Numerous patterns were identified suggesting new or different tax policy, regulatory responses, enforcement mechanisms and/or ethical standards are necessary. Many original recommendations were developed for new management strategies, regulatory schemes and enforcement mechanisms. These findings were generalized for noncharitable nonprofits as well and proposed legislation was reviewed and found to be lacking certain essential elements.

This abstract accurately represents the content of the candidate’s thesis. I recommend its publication.

Signed

Michael Cortés
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CHAPTER 1
INTRODUCTION AND OVERVIEW

Introduction

Legal and Ethical Crisis

There is general agreement in the nonprofit literature that the nonprofit sector appears to be in a state of crisis. Respected authors and practitioners such as Elizabeth Boris, Director of the Aspen Institute’s Nonprofit Sector Research Project,\(^1\) James Joseph, President of the Council on Foundations,\(^2\) Teresa Odendahl, noted author on nonprofit issues,\(^3\) Professor Jon Van Til, former editor of *Nonprofit and Voluntary Sector Quarterly*,\(^4\) have all surfaced the issue of ethics for nonprofits as one


of the sector’s greatest challenges for the ‘90s. The press has recently reported numerous instances of questionable ethics and illegal behavior by nonprofits including: outright fraud as in the William Aramony scandal at the United Way; the Philadelphia Inquirer series criticizing the sector and many of its practices; and the United Cancer Council case involving purported unethical solicitation practices.

These illegal behaviors have prompted more than 40 states to enact laws to regulate nonprofits, professional fund raisers or both with most being adopted in the last ten years. Twenty-two states have reported an increase in the number of complaints about charitable solicitations and organizations in the last two years. Ten of those have indicated that complaints were up substantially. More than twenty states have enacted new fundraising laws or tightened existing ones in the last three years and at least five other states are considering action.

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8 Goss, Kristin A., A Flawed System for Stopping Charity Fraud, THE CHRONICLE OF PHILANTHROPY, November 30, 1993, at 1; and Goss, Kristin A. and Williams, Grant, Deceptive Telephone Appeals for Charity No. 1 Problem for State Regulators, same issue, at 27.

9 Bush, Betsy Hills, Legislative Activity Picks Up, THE NONPROFIT TIMES, March, 1994, at 8. See also HARRIS, ELLEN, HOLLEY, LYNN S., AND MCCAFFREY, CHRISTOPHER J., FUNDRAISING INTO THE 1990S: STATE REGULATION OF CHARITABLE SOLICITATION AFTER RILEY, (N.Y.U. School of Law, 1989) (e.g., “Charitable solicitation laws also serve to regulate the ‘charitable environment’ by promoting the public’s perception of the integrity and efficiency of charities. These laws may
Due to the increased attention directed at the nonprofit sector, the federal government has also begun to take action to review and regulate the activities of nonprofits: 1) the Oversight Subcommittee of the House Ways and Means Committee has been holding a series of public hearings concerning the increase in the incidence of abuses by tax exempt organizations;\textsuperscript{10} 2) the White House has suggested the imposition of a new excise tax aimed at perceived abuses by charities;\textsuperscript{11} 3) two bills awaiting action in Congress would give the Federal Trade Commission greater powers to curb charity fraud in direct mail and telemarketing campaigns; 4) the Internal Revenue Service has prescribed new reporting and disclosure requirements for charities aimed at eliminating fraud and misrepresentation in solicitation materials; and 5) even the FBI is investigating several cases of charity fraud across the country.\textsuperscript{12}

represent a state’s response to a perceived growing public perception that charitable donations are used only to solicit more charitable donations in seemingly endless waves of unwelcome junk mail.”).

\textsuperscript{10}See e.g., Panel Two: Proposals for Intermediate Sanctions for Charitable Organizations, 9 EXEMPT ORGANIZATION TAX REVIEW 530, 549 (March, 1994); and Panel Three: OBRA Changes Affecting Lobbying Activities by Exempt Organizations, same issue, at 550, 556. See also Streckfus, Paul, and Jakubowicz, Peter, Oversight Panel's Hearing on Charities Was Worth the Wait, 60 TAX NOTES 7 (August 9, 1993).


\textsuperscript{12}Goss and Williams, \textit{supra} note 8.
All this activity means "current conditions indicate that the potential for conflict will not abate, and probably will intensify."\textsuperscript{13} Thus, the sector needs to begin to assess what alternatives to expanded government regulation might exist. In order to assess alternatives a better understanding of the nature of the crisis is necessary.

**Defining the Crisis**

*Webster's Ninth New Collegiate Dictionary* defines a crisis as "an unstable or crucial time or state of affairs in which a decisive change is necessary or impending; especially one with the distinct possibility of a highly undesirable outcome."\textsuperscript{14} This definition appears to be close to perfect to describing the current state of affairs for the nonprofit sector. The reporting of instances of nonprofits involved in all types of fraudulent, criminal and unethical actions has become all too frequent. Some recently reported incidences involved Medicare and insurance fraud, child abuse, mail fraud, phone solicitation fraud, theft, malfeasance, conspiracy, breach of fiduciary duty, to less serious acts or failures to act including excessive compensation or benefits, use of charity assets without remuneration, loans, valuation overstatements, or deals that are not arm's length between a charity and its donors, founders, officers, directors or trustees.

\textsuperscript{13}\textsc{Facchina, Bazil, Showell, Evan, and Stone, Jan E., Privileges & Exemptions Enjoyed by Nonprofit Organizations: A Catalog and Some Thoughts on Nonprofit Policymaking, 6, (N.Y.U. School of Law, 1993).}

\textsuperscript{14}\textsc{Webster's Ninth New Collegiate Dictionary, 307, (Merriam-Webster, Inc., 9th ed., 1984).}
Any act or failure to act that is outside the scope of an organization's charter or any action inconsistent with a broader charitable purpose could be symptomatic of a legal or ethical crisis. Almost any act that resulting in litigation related to a charitable organization's tax exempt status is almost assuredly indicative of a noncharitable purpose and most likely violates some public policy, legal or professional standard.

There appears to be no clear agreement as to the origin of this apparent crisis. Some authors have intimated that the so-called crisis may be the result of relaxed morals and ethics,15 and some say it stems from increased enforcement.16 The rapid growth in the size of the sector may have contributed to the crisis or the crisis may simply be a perception created by the media hype of a few abusive instances.17 A prevalent response in the nonprofit literature is that this is most likely a crisis of confidence rather than a lapse of morality.18 The growth in numbers and dollars controlled by the nonprofit sector may have begun to attract scam artists and shysters19 just as any profitable endeavor might yet, many of these authors feel that these incidences are few and far between.20

15 Boris and Odendahl, supra note 1, at 188.
16 Bush, supra note 9, at 8.
17 Gaul and Borowski, supra note 6.
18 Joseph, supra note 2, at 38; see also Suhrke, Henry, The Image of Nonprofits and Their Financial Statements, PHILANTHROPY MONTHLY, Jan./Feb. 1993.
20 Id.
In addition, in many of the accounts about the crisis, there appears to be some confusion about the difference, if any, between a charitable organization and an exempt organization. This has led to the reporting of some rather egregious instances of fraud and other illegal acts which, although perpetrated by noncharitable nonprofits, they have been attributed to charity. Charitable organizations which are the primary focus of this analysis are generally distinguished from other nonprofits by a statutory proscription against distributions or other unfair benefit to persons in control and a requirement they operate “exclusively” for charitable purposes. Charitable purposes include religious, educational, literary, artistic, scientific and other eleemosynary goals. These requirements are described in some detail below. Many of the abusive instances illustrated recently in the literature have failed to make this distinction. However, the nonprofit literature recognizes that regardless of who perpetrated these acts or whether there is an actual increased incidence of abuse by charities, the reality is in the perception and the public believes the problem is pervasive. Because the general public has a higher ethical standard for charity than for business (or government for that matter), any incident of illegal or unethical behavior is greatly upsetting and unacceptable: “(T)he greatest possible portion of the wealth donated to private charity must be conserved and used to further the charitable, public purpose; waste must be minimized and diversion of funds for private gain is intolerable.” (emphasis added).

21Joseph, supra note 2.

22Gaul and Borowski, supra note 6.

23FACHINA, SHOWELL AND STONE, supra note 13, at 7. See also Celis, William III, Leaders Say Charity May Be Dismantled, NEW YORK TIMES, March 7, 1992, at A10; and HARRIS, HOLLEY, AND MCCAFFREY, supra note 9, at 10 ("growing public cynicism . . . eroding public confidence . . .").
However, this crisis may be much more than a mere public relations problem for the sector. It is an issue with broad public policy implications:

Of almost equal concern as the danger of actual quid pro quo arrangements is the impact of the appearance of corruption stemming from public awareness of the opportunities for abuse...the avoidance of the appearance of improper influence is also critical...if confidence in the system of representative government is not to be eroded to a disastrous extent.25

Without widespread public acceptance of and confidence in charity, the sector will not receive the private donations, legislative support and governmental cooperation it needs and many essential public services and benefits might not continue to be available. Charities ensure, at least in part, that a large variety of public services and benefits are available that business or government either cannot or will not provide or cannot provide as efficiently. The health of society is greatly dependent upon the health of the voluntary sector.26

Ott and Shafritz define “crisis intervention” as “an effort to help an individual experiencing a crisis to reestablish equilibrium.” And a “crisis” as “a turning point in a person’s life [or]...anything that tests the limits of an individual’s ability to cope.”27

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24HARRIS, HOLLEY AND MCCAFFREY, supra note 9, at 10.


26MAPPING THE THIRD SECTOR: VOLUNTARISM IN A CHANGING SOCIAL ECONOMY, supra note 4.

The current state of affairs for the entire nonprofit sector is a crucial one; a turning point that could lead to greater and greater government regulation and intervention. The cry for tax reform for nonprofits has gotten louder and louder in recent years and suggested responses to those cries offer the “distinct possibility of a highly undesirable outcome.”

Ethical concerns frequently motivate policy changes.

This crisis is an opportunity to “reestablish equilibrium” through improvements in nonprofit sector tax policy, management and governance. In beginning to think about opportunities for improvement, the federal tax law is first brought to mind as it presents perhaps the best opportunity for affecting policy or enforcement mechanisms relating to this very diverse group of organizations.

The Importance of Tax Policy

Of primary concern is how federal tax law affects charities and their exempt status. “Though federal tax law is only one of several bodies of law that bear on nonprofits, its impact is particularly pervasive in terms of both positive encouragement and extensive regulation and oversight.”

The exemption statutes in the Federal Tax

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Code have historically defined nonprofit organizations in large part.30 This connection to the Tax Code arose primarily out of the necessity to define those entities subject to income or other taxes. Charitable, religious and other not-for-profit organizations obviously existed well before the Tax Code, thus most tax legislative efforts have recognized a preferred nontaxable status for these organizations.31 Exemption for charity has persisted since at least the British Statute of Charitable Uses of 1601.32 The first major piece of U.S. tax legislation enacted in 1894 specifically excluded charitable organizations from taxation.33 To prevent unqualified organizations from availing themselves of the exemption, it became necessary to define what constituted a charitable organization. This particular Act was declared unconstitutional a year later. Yet, exemptions have appeared and persisted in every major piece of tax legislation over the last 100 years.34


34See Scrivner, in Gies, Ott and Shafritz, supra note 30, at 126.
Over time the sector has developed a kind of security in or reliance on the Tax Code that is quite real and probably inescapable. “[A] history exists that interweaves the development of the field of nonprofit[s] . . . with the history of tax exemption and other tax policies that impact propensities toward charitable giving.”35 In part this may be due to the public’s interest in tax reduction through charitable contributions and a general distrust of big government and its ability to offer certain desired public goods or services. It may also relate to the public benefit argument; that is, charitable exemptions are often justified on the basis that the exempt entity confers a public benefit. Thus, it follows that organizations who see themselves as providing a public benefit believe they are entitled to special treatment under the law. The preservation of this preferred status has become very important to these organizations (i.e. “exemption is an integral part of forming and maintaining charitable . . . organizations”)36 at least in part due to this distrust; a belief in the power and responsibility of the individual; a desire for a wider variety of public goods and services than government or business can offer; and a desire to maintain some degree of independence for the nonprofit sector.37 Some believe that avoiding the burden of

35 Block, Stephen R., A History of the Discipline, in Gies, Ott, and Shafritz, supra note 30, at 55. See also, Odendahl, Teresa, Independent Foundations and Wealthy Donors: An Overview, in AMERICA’S WEALTHY AND THE FUTURE OF FOUNDATIONS, supra note 3, at 10 (“In a society suffused with taxes and reliant on them as engines of social and economic policy, the union of charity and taxes is in reality indissoluble - and controversy therefore inevitable. Charity seems destined to be enmeshed in tax policy debate . . . because, over the years, we have come to entrust to the tax system a central role in the nourishment and regulation of the nonprofit sector.”) (footnote omitted).

36 Block, supra note 35, at 53. See also, Atkinson, in RESEARCH AGENDA: LEGAL ISSUES, supra note 29, at 5 (“[g]iven the pervasiveness of tax law in the nonprofit sphere . . . .”).
most forms of taxation that the exemption allows, permits these organizations to retain substantial resources for use in their charitable function, a major advantage over forprofit businesses. The perception persists in the sector that “the contemporary nonprofit organization would adversely suffer if not for the benefit of not having to pay income taxes, as well as the incentives of the tax deduction given to its contributors.”

Exemption qualification allows charities and certain other nonprofits to accept tax deductible gifts which most believe is extremely important to their ability to generate necessary resources. Contributions are only tax deductible if to certain types of nonprofit organizations (e.g., contributions to agricultural, business, trade or industry groups, cooperatives, social welfare organizations and numerous other classes of exempt organizations are not deductible). The Code lists the organizations qualified to accept tax deductible contributions in Section 170. The list of organizations qualifying for acceptance of charitable gifts under Section 170(c) includes charitable

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37 Odendahl, supra note 35.


39 Block, supra note 35, at 53.

organizations but also many other noncharitable organizations such as governmental entities, war veterans' associations and fraternal benefit societies. This list is much broader than the definition of charitable organizations under Section 501(c)(3), the exemption statute, which as mentioned above, is limited to charitable, religious, scientific, literary and similar organizations. Nonetheless, most Section 501(c)(3) exempt charitable organizations would not risk losing their exempt 501(c)(3) status because of the tax savings it allows, the other benefits available to charitable organizations (e.g. exemption from antitrust law; property tax exemptions; preferred postal rates, etc.), and the fact that the law permits only qualified 501(c)(3) organizations to give donors advance assurance as to deductibility of gifts. This advance assurance may give charities a competitive edge over other gift receiving organizations when competing for gifts. Thus, exemption for charities may be of greater perceived importance. The text below and in chapter 2 provides additional definition and discussion of the nature of exempt status.

A fundamental change in tax policy away from an income tax deduction for charitable gifts to some other form of “subsidy” (see II below and Chapter 2) such as a tax credit might reduce the importance of the exemption to charitable organizations or, those other benefits might outweigh tax considerations. The point is probably moot given the legislature’s apparent aversion to fundamental tax policy changes. Thus, the perpetuation, implementation and enforcement of favorable and consistent tax policy is important to the continuing qualification of charitable organizations for exempt status.

41Slocumbe, Walter B., Charities and Federal Taxes: Issues for Analysis, RESEARCH AGENDA: LEGAL ISSUES, supra note 29, at 2 (“Exemption is important less for current tax savings on income than as the threshold test for eligibility for other benefits - especially deductibility of contributions.”). See also FACHINA, SHOWELL AND STONE, supra note 13.
Despite this connection through the tax law, charitable organizations' missions are extremely diverse, often very specific or narrow, traditionally nonconformist, and frequently more unintegrated than either the private business or governmental sectors.\textsuperscript{42} This fact may preclude the near term development of other generalized legal or ethical standards of the type effective in business and government and lends additional weight to the need for favorable and consistent tax policy. In any case, there is no one overarching professional organization that could draft and/or enforce ethical standards for nonprofits nor any:

\begin{quote}
[E]ntity in the political or regulatory process that oversees, regulates, studies (and sometimes promotes) the activities of the nonprofit sector or polices nonprofits on a global scale so as to discourage abuses of nonprofit status. There is no department of the federal government charged with regulating nonprofits on a large scale, or with studying issues affecting nonprofits on a global scale. Consequently, no department considers or advances their interests or provides necessary checks, as is the case with other areas of the economy, such as the securities, aviation, and communications industries . . . . The perceptions that the nonprofit sector is degenerating from an engine of social good into a cloak for private interest seeking privileges to the detriment of the public . . . may well stem from the lack of an influential government agency dedicated to regulating nonprofits from a global perspective.\textsuperscript{43}
\end{quote}

This lack of an advocate makes sound and consistent tax policy even that much more important to charities. Another argument for consideration of affecting tax policy first is the fact that:

\textsuperscript{42}FACHINA, SHOWELL AND STONE, supra note 13, at 10.

\textsuperscript{43}Id.
The privileges and exemptions granted nonprofits have evolved on an *ad hoc* basis . . . . Congress . . . has not proven an effective architect of comprehensive nonprofit policy. It has been unable even to articulate a clear policy for regulating nonprofits. Witness the scanty legislative history about and *ad hoc* character of most provisions of law affecting nonprofits. Exemptions have been created based on the exigencies of the nonprofit sector. Nonprofits tend to come to the attention of Congress and state legislatures only when complaints are aired concerning their activities . . . .

The demographics of the nonprofit sector reflect its broad diversity. As of 1992, there were over 1,140,000 tax-exempt organizations, of which some 546,000 were various kinds of exempt Section 501(c)(3) charities (excluding churches). There were another 38,000 charitable trusts and family and corporate foundations. One percent of these charitable organizations control seventy-seven percent of the annual expenditures of all nonprofit organizations. Charities also controlled seventy-five percent of all nonprofit assets and received more than fifty-one percent of all contributions. Thus, there are literally hundreds of thousands of small community based groups.

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44 FACHINA, SHOWELL AND STONE, *supra* note 13. *See also* McGovern, J., *The Exemption Provisions of Subchapter F*, 29 TAX LAWYER 523, (1976) ("Exempt organizations are not the result of any planned legislative scheme . . . but were enacted over a period of 80 years by a variety of legislators for a variety of reasons.").


47 *Id.*

48 *Id.*
The diversity in size and type of nonprofit organizations is such that tax policy is the only possible way to be sure of affecting all organizations when making policy choices at the federal level. Thus, when examining opportunities for fundamental policy change the best way to approach it is through the tax law:

Any comprehensive analysis of charities and the law must consider tax issues, for in the United States, the tax law is the principal way in which the federal government interacts with charities, both to support by exemption and gift deductibility, and to regulate by conditions on qualification for such support.49

Because tax policy may be the only comprehensive way to affect such a large and diverse group of organizations, an evaluation of case law affecting charitable organizations could provide detailed information about charitable organizations’ behavior, its affect on continued qualification for exemption, and could suggest more comprehensive solutions to abuses than could be achieved through any other process. Suggestions for more effective tax legislation, enforcement mechanisms or professional standards should become readily apparent. Further understanding of the rationale for exempting these organizations should lend additional credence to the importance of tax policy to the nonprofit sector.

**The Rationale for Tax Exempt Status**

Exemptions arose out of administrative necessity to define what organizations had historically been beneficial to society at large and which, therefore, should be

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exempt from some tax initiative.\textsuperscript{50} Some authors have explained the exemption from federal income tax enjoyed by charitable organizations as an unconstitutional subsidy.\textsuperscript{51} There remains a substantial debate over the rationale for providing a broad federal subsidy such as tax exemption even though the value of the nonprofit sector is widely acknowledged. In light of the numerous instances of ethical breaches outlined in the press recently and the substantial and growing share of the national economy represented by the sector, some authors have suggested that there should be a better way to assist these organizations.\textsuperscript{52} Hansmann has suggested that if there isn’t a better way, then the public needs a more widely accepted rationale for exemption than tradition or history.\textsuperscript{53}

In general there are three major theories of the rationale for a federal tax exemption for charity: 1) the traditional subsidy theory;\textsuperscript{54} 2) an “income definition” theory;\textsuperscript{55} and 3) a “capital formation” (also referred to as “contract failure”) theory.\textsuperscript{56} In addition, there are some minor theories including the “donative” theory, the

\begin{itemize}
\item \textsuperscript{50}Hopkins, Bruce, The Law of Tax Exempt Organizations, (5th ed., 1987).
\item \textsuperscript{51}Hansmann, \textit{supra} note 38.
\item \textsuperscript{52}See \textit{e.g.,} The Future of the Nonprofit Sector: Challenges, Changes, and Policy Considerations, (Hodgkinson, Virginia A., et. al., eds.,1989).
\item \textsuperscript{53}Hansmann, \textit{supra} note 38.
\item \textsuperscript{55}Bittker and Rahdert, \textit{supra} note 32, at 302-304.
\item \textsuperscript{56}Hansmann, \textit{supra} note 38.
\end{itemize}
“altruism” theory, and “transaction costs” theories. Chapter 2 examines these theories in detail. Despite the disagreement over what is the appropriate rationale, there appears to be substantial public policy grounds for perpetuation of the exemption statutes. The Supreme Court has observed “the State has an affirmative policy that considers these groups beneficial and stabilizing influences in community life and finds this classification [exemption] useful, desirable and in the public interest.” Despite the continuing disagreement over the appropriate rationale, an understanding of these theories may help inform what public policy, enforcement or other initiatives, if any, might be effective in dealing with this purported legal and ethical crisis in nonprofit organization governance evidenced recently in nonprofit litigation and literature.

This analysis will, therefore, describe the various theories or rationales for tax exemption for charities; will identify criteria from the theory, the law, and the literature for the purpose of evaluating charitable organization’s compliance; will develop a typology of charities’ illegal behaviors; will review the affect, if any, these illegal behaviors had on exemption; will describe this apparent crisis of confidence; and will review tax litigation for information as to what behaviors occur most frequently and which are most likely to cost a charity its exemption. This effort should provide clues


to possible responses including, what legislative, enforcement or other initiatives might be effective in addressing the crisis.

Advancing Public Policy

The goals of this study are to enhance understanding of the legal and ethical implications of management decisions on continuing qualification for exemption; to surface which public policy (tax policy) initiatives, enforcement mechanisms or professional standards might be most effective in dealing with illegal or unethical behaviors; and to provide information needed to positively affect the whole sector. By making known the most frequently reoccurring behaviors and by providing charities’ managers and trustees with suggestions for avoiding them, this study may improve charities’ governance. New and important information about exempt status and how to protect it may become apparent that might be generalized to other types of exempt organizations or agencies to positively affect legal and ethical standards in other parts of the voluntary sector or in government. This new data could advance knowledge of public administration and nonprofit management in general.

Possible Public Policy Responses

The literature suggests a variety of responses to deal with ethical concerns about the nonprofit sector. The most talked about responses are new codes of ethics, administrative tribunals, more government intervention into nonprofit governance, “intermediate sanctions,” greater board culpability, new legal procedures or ethical or professional standards or systems, and various other responses all aimed at ensuring organizations are deserving of exemption. The prospect of intermediate sanctions for
violations such as excessive compensation or benefits, acts of self dealing, or other unethical or illegal acts is very real. The Oversight Subcommittee of the House Ways and Means Committee is preparing various proposals for fines, excise taxes, additional accountability and disclosure requirements, along with closer monitoring of nonprofits activities. These proposals, if adopted, would mitigate the necessity of stripping a charity of its exemption because one of its members, founders or directors inadvertently or otherwise perpetrated some act considered to be outside an acceptable range of acts for charitable organizations.

Because of the size and diversity of the nonprofit sector it is highly unlikely any organization could cause the adoption and enforcement of broadly accepted codes of ethics. However, if the sector cannot or will not police itself, the government will take action to “legislate morality.” The only way to positively affect such a large and diverse group of organizations is through the federal tax policy. While tax initiatives are unlikely to eliminate the inappropriate behavior, they can act as a deterrent. This study may provide new information gleaned from the case law about which issues require the most immediate attention, and thus, could surface what responses might be most effective.

Judicial Decisions and Public Policy

Judicial decisions are often statements of public policy and the direct result of a purported illegal act. These decisions are one of society’s ways of attempting to control the acts of its citizenry through the enforcement of public policy by application of the law. The judiciary does an excellent job of documenting the facts and issues of each case before them which helps facilitate an understanding of the decision reached.
This documentation may provide important and particularly relevant information about illegal behaviors and their affect upon exempt status for charitable organizations.

A review of the *American Federal Tax Reporter*\(^{60}\) and *United States Tax Cases*\(^{61}\) indicates some 720 to 750 decisions since 1954 dealt with exemption issues (Chapter 3 provides additional information about the research population). This body of case law can provide hard evidence of individual failures of charitable organizations to live up to the legal or public policy standards regarding exempt status.

Since adoption of the modern exemption statute there has been very little questioning of whether the criteria in the statute are the correct criteria and whether or not the IRS is the proper government enforcer of the public’s expectations as to appropriate nonprofit behavior. It may be useful in this regard to establish what acts or failures to act are repeating themselves in the case law which are outside current legal and public policy standards for exempt status. It may be possible to achieve improvements in nonprofit governance by making known those behaviors which the Internal Revenue Service is most likely to pursue and by identifying those which the Service is having the most success prosecuting. This knowledge may provide clues as to how to respond to this crisis of confidence through improvements in law, policy, enforcement or practice standards. A general description of the making of tax policy should be beneficial to illustrating the importance and usefulness of case law in evaluating exemption standards in this regard.

\(^{60}\) Published by Prentice-Hall, Englewood Cliffs, New Jersey, (1995 ed.).

\(^{61}\) Published by Commerce Clearing House, Chicago, Illinois, (1995 ed.).
The Making of Tax Policy

The making of tax policy is a complex process involving the courts and the legislature. Since the mid-1970s, appropriations and budget action has largely driven tax policy. Thus, tax policy has become more an instrument of social and economic policy than it was previously. The federal budget has become "an expression of practical politics." That is, it often reflects public policy through achievement of political goals of the varying groups having input into the process. The tax legislative process is, therefore, not a separate or distinct process, but is very much affected by public policy or social opinion. This perhaps, is one of its weaknesses. There are substantial dysfunctions inherent in the process. A few comments about those dysfunctions are particularly pertinent.

Public opinion or representations of the public interest come to the legislators from a variety of sources including the courts, direct contact with their constituents, national citizens' organizations, organized and unorganized public interest groups, special interest groups, administration officials, invited experts, industry or trade groups, and lobbyists. Often the Secretary of the Treasury must act as "defender of the national interest." This is not the most efficient method for developing fair and comprehensive policy. It sets up an adversarial situation in many instances between the government and the citizenry, or at least certain interested parties. Similarly, the courts are often defenders of tax policy after the fact.

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Unfortunately, it is unclear just what are the proper boundaries of governmental power and more specifically, what are the proper functions of the three branches of government. This confusion and the resulting overlap in the three branches of government makes the development of public policy and tax policy through the legislature increasingly complex. The making of tax policy through the courts, however, may be one of the more direct and timely functions of government as it relates to charitable organizations. Case law reflects public opinion through citizen’s participation on juries, in the legal profession, through election of judges and as litigants. Every day the courts are documenting the trends in nonprofit governance. This data can help us identify opportunities for correcting dysfunctions.

Overview of Judicial Policy Making

Despite Congress’ persistence to the contrary, the courts can and do make policy, including tax policy. In fact, this may be the most important function for courts having jurisdiction over federal tax matters:

Since the early 1950s, the courts have been the most accessible, and often, the most effective instrument of government for bringing about changes in public policy . . . . The legitimacy of public policy litigation and of judicial authority to deal with a broad range of issues on balance seems more firmly established, and deservedly so, than ever before . . . . (L)itigation compels the other branches of government to become more representative.  

64 NEIER, ARYEH, ONLY JUDGEMENT: THE LIMITS OF LITIGATION IN SOCIAL CHANGE, (1982).
The judiciary can and does make public policy choices. Their efforts in defining charity have been particularly important. "The courts are heavily involved in the issue of what constitutes philanthropy and are busily churning out opinions that find nonprofit organizations not to be tax-exempt, as charities or otherwise, because of their engagement in activities that can be characterized as 'commercial,' 'competitive,' or both."\textsuperscript{65}

An example specific to the issue of public policy affecting tax exempt organizations is that of the Supreme Court decision in \textit{Bob Jones University}. In stripping \textit{Bob Jones University} of its exemption the Court emphasized that any violation of some fundamental public policy requires an adverse determination as to exempt status qualification. This case dealt with discriminatory admissions policies, but it also established precedent for interpretation of issues beyond those involving discrimination. Now the violation of any fundamental public policy is basis for denial of exemption. The exemption statute only requires operation exclusively (primarily) for public purposes, avoidance of private inurement (unwarranted payments or benefits to insiders), avoidance of excessive lobbying expenditures and a prohibition of expenditures on political campaigns (see Chapter 2 for a more detailed definition). In the present statute, there is no requirement that organizations operate within the confines of accepted public policy. The Supreme Court explicitly recognized this expansion, as well as the traditional subsidy theory of exemption when in \textit{Bob Jones University} they observed: "[c]haritable exemptions are justified on the basis that the exempt entity confers a public benefit—a benefit which the society or the community

may not itself choose or be able to provide, or which supplements and advances the interests of public institutions already supported by tax revenues." 66

It is clear therefore, that the case law can provide important information about charitable organizations and exempt status. This information may suggest what policy, enforcement or other mechanisms might be effective in dealing with the crisis. A more complete understanding of the role of charity in society will be useful in identifying those possible responses.

**The Role of Charity**

The original colonists brought charity with them. Exemptions just institutionalized common practice. "No one decided, on a clean slate, that exemptions were appropriate. They already existed . . . ." 67 This historical justification is long-standing. 68 Charity has long been an ingrained part of American society.

The discomfort apparent in the literature about purportedly relaxed ethical standards in charities reflects this long-standing, pervasive and unique role charities


68 Block, supra note 35, at 54 ("[G]overnment-endorsed tax exemption in the United States has been a common practice since the nation’s founding.") (footnote omitted).
play in American society. Most consider philanthropy or charity synonymous with doing good or being ethical. Unfortunately, there is widespread confusion about the difference between charitable and tax exempt which may have led to some distrust of charities. Chapter 2 covers this issue in some detail. Nonetheless, even without consideration of religious organizations, nearly every aspect of American life is touched in some way by nonprofits (charitable and noncharitable) including health and welfare, prevention of cruelty to children and animals, amateur sports, housing and urban development, economic development, organized labor, law enforcement and fire protection, social and business associations, agriculture and conservation, civil rights, insurance and other mutual benefit societies, armed service veterans, transportation, free speech, and education.

Because of the confusion about the nature of charity and the high ideals and altruistic purposes that the public seems to expect from all nonprofits, it is that much more disturbing when one fails due to an illegal or unethical act. The size of the sector and the large sums of money now commanded by the sector have apparently attracted at least a few con artists and this upsets the publics' sensibilities, so much so that "intermediate sanctions" are being debated by the Congress as a means to deal with the apparent epidemic.

69Rubin, Hank, Dimensions of Institutional Ethics: A Framework for Interpreting the Ethical Context of the Nonprofit Sector, in Gies, Ott and Shafritz, supra note 30; GLASER, supra note 5; Streckfus and Jakubowicz, supra note 10.

This is a time of rapid social change. "The medieval village has been supplanted by Spaceship Earth. The demands of contemporary life, collective and individual, emphasize that we have never needed charity more than we do today." Charity helps to define modern life and acts as a mediating force between the individual and government and business. Life would be shallow, materialistic and controlled without charity. Charity may even be more than a conscious choice, but some authors describe it as "cultural tradition," a "social requirement," or a "religious injunction," even as "an intervention of nature itself"; a "biological mandate." 

Charity also often reflects an expression of the uniquely American democratic or pluralistic bent. Laws designed to regulate the activities of charity thus, may inhibit free speech or expression and discourage a diversity of ideas and opinions. The health of charity affects, at least in part, the health of society. The continued health of charity and thus, society, is dependent upon the tax rules defining charity.

Scope and Legal Definition of Charitable Organization

Federal income tax law exempts a variety of organizations and associations. The primary focus of this paper is the charitable subset of exempt organizations which is by far the largest and most diverse of the various categories, including those organizations organized for religious, scientific, literary, educational and similar

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71 Van Til, Mapping the Third Sector, supra note 26, at x.


73 Harris, Holley and McCaffrey, supra note 9, at 16.
purposes. These organizations are the subject of numerous texts and studies. *Black’s Law Dictionary* defines a charitable institution as:

> [O]ne which dispenses charity to all who need and apply for it, does not provide gain or profit in a private sense to any person connected with it, and does not appear to place obstacles of any character in the way of those who need and would avail themselves of the charitable benefits it dispenses . . . \(^{74}\)

Not all charitable organizations meet this definition, but nonetheless may qualify for exemption. Because the charitable subset is extremely diverse in purpose, character and method of operation it is difficult to confine it to a definitional box. There may be no optimal definition for charity. This is perhaps one of the sector’s strengths; this definitional ambiguity promotes flexibility, diversity, free speech and association. It may also be one of its weaknesses as the lack of concrete criteria applicable to all charitable organizations has led to some of the confusion and current criticism. But, by keeping the definition broad and flexible the sector has grown in value and importance and in its ability to deal with contemporary issues.

The charitable subset includes churches, synagogues, community service organizations, hospitals, health and human service organizations, private schools, colleges, universities, children’s organizations, museums, arts and cultural organizations and numerous others. The charitable subset accounts for some 93% of the employment and 94% of total expenditures of the entire nonprofit sector.\(^{75}\) Total assets of the charitable subset (excluding religious organizations for which very little


\(^{75}\) *Hodgkinson, Weitzman, Toppe and Noga*, *supra* note 46.
data is available) grew approximately 271% between 1975 and 1985 to about $497 billion\textsuperscript{76} and had reached nearly $600 billion by 1990.\textsuperscript{77}

The charitable group was the fastest growing sector of the American economy from 1975 to 1990 increasing its proportion of national income from 5.2% to 5.7% between 1975 and 1984, and jumping to an astounding 8% of Gross Domestic Product (GDP) by 1990.\textsuperscript{78} While GDP increased 52% between 1975 and 1990, total revenue and expense of the charitable subset grew by more than 225%.\textsuperscript{79}

Despite its size and diverse purposes, the same tax laws govern the whole subset. Section 501(c)(3) of the 1986 Internal Revenue Code defines a charitable organization to include:

\begin{quote}
[C]orporations, and any community chest, fund, or foundation, organized and operated \textit{exclusively} for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition \ldots or for the prevention of cruelty to children or animals, \textit{no part of the net earnings of which inures to the benefit of any private shareholder or individual} \ldots (emphasis added).
\end{quote}

\textsuperscript{76}Id.


\textsuperscript{78}Tax Watch, \textit{supra} note 44, at 33. \textit{See also} Skelly, \textit{supra} note 75, at 1131.

\textsuperscript{79}Tax Watch, \textit{supra} note 44, at 33.
The major issues concerning compliance by charitable organizations are the exclusivity requirement (public benefit) and private inurement prohibition (nondistribution constraint) contained in the statute (the highlighted phrases above). In addition, attention must be given to what other criteria might be available in theory, litigation or literature to assess compliance and what action, if any, can be taken to more closely conform practice with law, theory or public opinion.

The basic organizational and operational tests of the statute quoted above appear to be simple and straightforward rules of conduct. But, the courts broadly interpret these rules, in some cases making implementation ineffectual. In addition, the courts have often confused the tests, applying one and then concluding failure of the other. For instance, the term “exclusively” has generally been held to mean “substantially” or “primarily” rather than “solely.”80 Thus, it’s no wonder the courts’ decisions confuse charities.

The courts have added the common law concept of charity as an additional requirement to meeting the statutorily enumerated classifications in Internal Revenue Code Section 501(c)(3).81 This means, it is not enough to meet the technical requirements of the exemption statute anymore, but an organization must in practice serve a broader public purpose than the statute requires. In addition, the Supreme Court has limited entitlement to exemption to activities that serve a public purpose and

80 OTT AND SHAFRITZ, supra note 27, at 143.

81 See Bob Jones University v. U.S., supra note 65.
do not contradict settled public policy.\(^{82}\) This is an even further expansion of the statute, and an obvious example of judicial policy making.

The courts have been quite active in defining public policy constraints for charitable organizations and there appears to be sufficient case law for an analysis of charities’ behavior. Over the 40 years between 1954 (the year that Section 501(c)(3) in its present form became law) and 1994, there were more than 720 cases dealing with exemption issues before the courts having jurisdiction over federal tax matters. Analyzing every one of these cases for types of noncompliant behavior may provide clues to possible policy, enforcement or other changes that could positively affect compliance and ultimately, public perceptions of the sector.

Other issues such as nonprofits’ business activities, a hot topic during the eighties and, certainly, one still subject to considerable debate,\(^{83}\) contain too many subissues to make analysis possible and the number of cases are too many for the limited time and space available. In addition, unrelated income cases contain very few if any exemption issues or ethical considerations. Unrelated income cases are more often simply factual determinations.

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\(^{83}\) See generally, Rose-Ackerman, *supra* note 38.
Purpose of Dissertation

There appears to be little comprehensive research and accordingly, little literature on the impact and implementation of judicial decisions affecting nonprofit organizations, particularly tax policy decisions. No single study exists that analyzed tax cases for types of compliance problems or clues to possible policy or enforcement improvements in this or any other field. Substantial literary and research efforts on other specific decisions in other substantive legal areas such as abortion\(^\text{84}\) or segregation,\(^\text{85}\) exist, but there is essentially nothing on nonprofits.

Although there appears to be a great deal of literature on the management and governance\(^\text{86}\) of nonprofits, it does not appear to have been informed by any systematic study of case law. In addition, there is substantial literature on ethics in government or ethics in general as well as tax policy in a general sense. The attached annotated bibliography illustrates the quality and variety of materials and research


\(^\text{86}\) e.g., Assoc. of Governing Boards of Universities and Colleges, Financial Responsibilities of Governing Boards of Colleges and Universities, (Ackley, et. al. eds., 1985); Odendahl and Boris, supra note 1; Smith, David H., Moral Responsibilities of Trustees, 2 Nonprofit Management & Leadership, (Summer, 1992).
dealing with nonprofit governance, ethics, tax policy, management and other related areas.

While some effort has been directed toward development of ethics codes and professional standards for management and trustees for nonprofits, these models are most often directed at specific types of organizations, are lacking in direction or quality, are anecdotal or case study oriented, or are single issue or more politically oriented than is greatly useful to the purpose at hand. Despite this large and growing body of literature, there appears to be a void which this study may be able to fill in part.

The objectives of this dissertation are as follows:

• Documentation of the theories or rationales for tax exemption;

• Description of the apparent crisis of confidence in nonprofit management and governance;

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87 Jeavons, Thomas H., When Management is the Message; Relating Values to Management Practice in Nonprofit Organizations, 2 NONPROFIT MANAGEMENT & LEADERSHIP (Summer 1992); NUTT AND BACKOFF, STRATEGIC MANAGEMENT OF PUBLIC AND THIRD SECTOR ORGANIZATIONS, (1992); Plant, Jeremy F., Codes of Ethics in Public Administration, ASPA/CASU 54TH NATIONAL TRAINING CONFERENCE, (July, 1993).

• Identification from law, theory and the literature the accepted criteria for behavior of charities to enable their continuing qualification for exemption;

• Analysis of litigation for information about types of compliance failures in charities' management and governance and clues to appropriate responses;

• Use of data or identification of trends for generalizing or suggesting appropriate tax policy, enforcement mechanisms or professional standards for charities and possibly other nonprofits.

The dissertation will take the following format:

CHAPTER 1—INTRODUCTION AND OVERVIEW—including statement of purpose, statement of definitions and scope, a brief description of the methodology and expected findings.

CHAPTER 2—ISSUES IN THEORY & POLICY—including descriptions of the theories on the rationale for tax exemption and of the criteria used therein to judge present nonprofit practice; an overview of the literature of crisis and other accepted criteria; a review of the nature of the current criticism of the sector and the national policy debate.

CHAPTER 3—METHODOLOGY—including description of the elements or research questions; description of the process of obtaining the data necessary to answer the research questions; description of the methods of
analyzing and summarizing such data, and documentation of the findings and effects.

CHAPTER 4—FINDINGS—includes complete descriptions of the findings of the research and possibly, some specific conclusions.

CHAPTER 5—CONCLUSIONS—summarizes the dissertation and its findings with a view toward generalizing the findings and conclusions derived to broader policy making decisions, legislative initiatives, enforcement mechanisms and/or practice standards.

A Note on Methodology

The study will be both analytical and historical in approach. It will be necessary to analyze each case involving exemption issues for types of legal or ethical breakdowns in order to document the types and patterns of illegal behaviors. The study will involve a descriptive survey of the case law, and development of a violation typology, combined with some individual case analysis. It will be necessary to carefully review each and every case for where it fits in the typology as evidenced in the discovery, adjudication, opinion and implementation facets of the case. For instance, cases allowing the organization to keep their exemption despite the presence of these behaviors might provide different or more particular insights into management, governance or policy issues and therefore, may need more detailed analysis.
Reviewing only fully adjudicated cases should satisfy the historical aspect of the study. The review will look for incidences of theft, misappropriation, malfeasance and other misdeeds evidenced in the case law. Charities' acts should fit into a typology of violations of trust which are in conflict with previously identified legal, public policy and theoretical criteria which can be documented through the use of tables of cases and evaluation of the pattern, if any.

Examples of the types of behaviors which may be present in the cases include cases involving payment of unreasonable compensation or non-arm’s length transactions with board members. This analysis may also determine, as evidenced by case law, the incidence of other behaviors or traits (e.g. lack of management training) and the relative importance these issues are in the finding of tax exempt status.

It appears prosecution of these illegal and unethical behaviors was limited prior to the adoption of the 1954 Internal Revenue Code. Clearly, litigation of the issues of exclusivity and nondistribution constraint did not occur to any great degree before 1954. In fact, there was relatively little litigation affecting charitable organizations at all during the 40 years prior to 1954. A search of the federal case law for exemption issues revealed only 136 cases prior to 1954 while the courts adjudicated more than 700 cases since 1954 involving all types of exemption issues. This increase is probably due in large part to the increase in the number of charitable organizations. While only about 100,000 charitable organizations existed in 1954, more than 500,000 existed in 1994.89 This is covered in greater detail in Chapter 3.

89HODGKINSON, WEITZMAN, TOPPE AND NOGA, supra note 46.
Chapter 3 of the dissertation will provide a working definition of each known type of behavior to allow for ease of identification in the case law. It also describes in detail the methodology used in identifying the types of legal breaches being litigated; in evaluating whether the standards used by exempt organizations as evidenced in the case law are consistent with accepted criteria; in comparing the relative importance of ethical or other non-legal issues in the finding for or against the nonprofit organization; and in performing the analysis of the cases.

Findings

Information will emerge from the case law supporting the hypothesis that the present statute and other accepted legal, theoretical, professional or public policy criteria are insufficient to adequately prevent or punish certain illegal or unethical behaviors which continue to repeat themselves more often than others. These behaviors are not representative of the public’s interests or consistent with the major theories on exemption, at least in part contributing to the crisis in confidence in the legal and ethical standards in nonprofit management and governance.

An entire chapter will be devoted to the findings and how they relate to current legislative proposals, with further discussion of what legislative action might appear appropriate and what generalizations, if any, follow from the findings. Legislative, enforcement or other options may become readily apparent after analyzing the litigation. It should be clear from the analysis of the cases what types of issues require the most immediate attention and what patterns of illegal behavior are repeating themselves. It may be possible to generalize the findings to assist other voluntary organizations and inform related policy matters. Perhaps in some small way this study
can positively impact this crisis of confidence by making known these patterns of behavior and suggesting new or different enforcement options.
CHAPTER 2
ISSUES IN THEORY & POLICY

The Rationale for Exemption

Introduction to Exemption Theories

Inextricably linked with the decision to grant an organization specially favored legal status is the identification of some characteristic that warrants this treatment. At the highest level of generality, the question is what is required for favored status, beyond the definitional requirement that net revenues not be distributed to controlling individuals?\(^1\)

Exemption theories represent scholars attempts to identify that unique characteristic. Charitable organizations’ favored legal status is often justified by the unique characteristics or criteria inherent therein. Thus, a complete understanding of the rationale for tax exemption can aid in understanding what makes charities different from other nonprofits. The predominant rationales or theories attempt to provide simple and broad justifications for the granting of exempt status, very often relying on economic terms or models. There has been tremendous debate, particularly in the

legal literature, over the necessity for such a broad subsidy as exemption, and even whether exemption is the right kind of governmental support for these organizations. This portion of the analysis explains some of that debate and describes the major theories particularly as they relate to charitable organizations (although they might apply as well to noncharitable nonprofits). This will assist in understanding whether present legal standards are effective arbiters of society’s collective conscience.

The General Nature of Exemption Theories

Exemption theories generally are descriptive in nature; that is they often describe what a charity is or does without any reference to the essence of charity. This is one of the weaknesses of theory. This tendency may be due at least in part, to the necessity of having those theories apply equally to noncharitable nonprofits as well as charities. It is difficult, however, to define charity fully in this descriptive sense as any definition of charity must by necessity contain a normative element that is the essence of charity.

The traditional subsidy theory, for instance, is more descriptive in nature and for the most part, lacks this value based normative element. The normative element is the common thread between all charitable endeavors. This common thread is the justification for exemption for charities. Thus, legal, economic, and accounting theories of charity often disappoint because they lack this common thread. This creates a tension between theory and practice, “a tension that is difficult to describe briefly without resorting to tendentious dichotomies like ‘theoretical versus practical’ or ‘academic versus professional’. 2 Few if any theories acknowledge this tension.

2 Id. at 3.
Nonetheless, a theory that does acknowledge this tension and attempts to integrate this value based element should certainly be preferable to those that do not. Names for that common thread include: virtuosity, selflessness, “other-regarding love,” self sacrifice, “sphere of benevolence,” and many other similar terms. This element is a deeply ingrained part of the American culture and its religious roots. Even studies involving animals suggest that selflessness may be an innate quality and so integrating that quality in theory and practice might be useful.³

We are accustomed to thinking of the organizations in question here as virtuous in a way associated with the words ‘charity’ and ‘philanthropy’, words related etymologically to the notion of selfless, other-regarding love. Moreover, we want an account of the charitable exemption in terms of that quality, an account that makes charity integral to the exemption, that shows the exemption to be tied to what makes the organizations charitable. A theory that does not make direct reference to this quality will disappoint us, even if it is elegant and internally consistent.⁴

This is a difficult concept to deal with in practice and it highlights the difference between the two branches of normative theory, the moral and the legal.⁵


The moral branch only identifies charity in the abstract, an overly broad sort of “family resemblance” view. Another name for this idea is the “duck” theory; that is if it walks like a duck and talks like a duck it must be a duck. This too, is overly broad and simplistic. While this moral branch is clearly beyond the scope of this analysis, a comment or two might prove instructive. This analysis would not presume to impose a definition on charity that cannot be supported. It seems that even nonprofit scholars cannot agree upon the meaning of charity which is understandable since the moral concept of charity changes with the “shifting social climate.”

The focus of the moral branch is one of motivation (versus supply and demand as in economic theory or administrative convenience or political necessity in legal theory); that is, the moral branch not only acknowledges altruism with respect to policy goals, but embraces it. Some common themes of the moral branch might be the emphasis of equity or administrative justice which necessarily involve a great deal of judgement. Because moral norms are different for each person, the possibility of ineffective oversight is obvious thus, inviting abuse.

The legal definition of charity must however, be applicable in practice as well as principle. The law requires certainty and predictability the moral branch cannot offer. Although intuitively appealing, selfless love is just a little bit too “squishy” a

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6 VAN TIL, JON, MAPPING THE THIRD SECTOR: VOLUNTARISM IN A CHANGING SOCIAL ECONOMY, 147 (1988) (“The meaning of philanthropy - altruistic concern or manipulative protection of privilege and position - continues to rage as a debate among voluntary action scholars.”).

7 Atkinson, RESEARCH AGENDA: LEGAL ISSUES, supra note 1, at 10, 11 (“With respect to motivation ... they may be more inclined to address ... political pluralism and diversity, social solidarity and community, economic justice and wealth redistribution.”).
concept for legal purposes. Unfortunately, “the legal definition of ‘charity’ is today quite confused.”\(^8\) In developing a legal definition of charity it is important to avoid a “know it when I see it” approach.\(^9\) Such an approach leads to vague and unpredictable law\(^10\):

If, as I have suggested, we want a theory that takes account of the ‘charity’ of charities, and if charity, like the love that we assume to be at its core, is a matter primarily of the heart, then, in seeking a legal definition in objective terms, we are bound to be disappointed . . . . (W)e can be sure from the outset that a legal definition of charity will not be entirely satisfactory, in large part because some of the things we want in an exemption theory are at odds with others.\(^11\)

Other definitions are readily available. Hansmann has suggested that:

\[\text{[I]t would be appropriate to define as charitable only those organizations that provide public goods in the economist’s sense of the term—that is, goods that exhibit both nonrivalry and nonexcludability. Nonrivalry means that it costs no more to provide the goods or services to many persons than to one. Nonexcludability means that once the}\]


\(^9\)Laird, D., *Phantom Selves: The Search for a General Charitable Intent in the Application of the Cy Pres Doctrine*, 40 STANFORD LAW REVIEW 973, 974-975 (1988). *See also*, Atkinson, *in RATIONALES*, *supra* note 4, at 9 (“[S]tate of mind may be as provable in principle as the state of digestion, but it is a good deal more difficult to prove in practice.”).


good is provided to one person, it is impossible to exclude others from enjoying its benefits as well whether or not they pay for them.\textsuperscript{12}

These ideas display themselves more clearly in Hansmann's contract failure/capital formation theory described below. Perhaps, the nondistribution constraint and exclusivity requirements of the exemption statute are as close as the law can get to a selfless legal definition of charity. This too will be explored in greater detail later. For now, at least, the nondistribution constraint and exclusivity requirements are the essence of the current legal definition of charity. The statutory prohibition against distributions of net revenue to persons in control (the nondistribution constraint) and the requirement that the organization serve exclusively public purposes (the public benefit or exclusivity requirement) comprise the current legal equivalent of other-regarding love (see sections II(A) and II(B) below for more developed definitions of these terms). By examining the major exemption theories perhaps it will be possible to better evaluate whether the present standards go far enough toward assuring the organizational heart is in the right place over time. The criteria necessary to evaluate whether a particular organization is a charity will emerge from theory, practice (case law) and public policy.

Any one of the existing theories can provide an \textit{adequate} (not optimal) rationale for exemption even without sufficient emphasis on the heart of charity and may provide information about what external criteria are available by which to judge present tax law. None of the theories can provide a complete rationale. The tax law provisions allowing exemption were not adopted with that much forethought but were "enacted over a period of eighty years by a variety of legislators for a variety of

\textsuperscript{12}Hansmann, \textit{RESEARCH AGENDA: LEGAL ISSUES}, \textit{supra} note 8, at 7-8.
It is clear, in retrospect, that many of the exemption provisions have long outlived their historic justification . . . . The legislative history for exemption as evidenced by Congressional committee reports for the 1913 and subsequent acts provides little or no justification for initiating or continuing this favored status. It has been justified for reasons of “heritage,” “morality or public policy,” and “special interests.” These are not however, fully developed theories, but subsets of broader exemption rationales. Theory has its shortcomings which must be acknowledged upfront. By taking those parts that are useful it may be possible to use them to develop criteria by which to evaluate present law and practice.

The academic discussion of the rationale for income tax exemption, in particular the three-way debate between the traditional subsidy theorists, Bittker and Rahdert’s technical definition theory, and Hansmann’s economically oriented capital formation theory, brings a measure of order to the Code’s . . . chaotic exemption categories . . . . The debate not only draws upon explanatory theories of the role of nonprofits; it also involves important normative issues about what that role should be, and how and whether it should be governmentally supported.

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The Major Theories

Traditional Subsidy Theory. "[T]he exemption for charitable organizations is a derivative of the concept that they perform functions which, in the organizations' absence, government would have to perform; therefore, government is willing to forego the otherwise tax revenues in return for the public services rendered."17 Commentators and the courts have long held and widely accepted this rationale. This theory in general explains the exemption from federal income tax as justified because the qualified organizations provide public benefits; that is they provide public type services to the general public (e.g. health care or education) or they provide ordinary or generic services to particularly needy publics (e.g. housing and food to the poor and homeless). Another important aspect of the traditional subsidy theory is that it allows exemption because of the way in which services are provided.

In the first place, they are said to deliver goods and services more efficiently, more innovatively, or otherwise better than other suppliers. In the second place, charities' very existence is said to promote pluralism and diversity, which are taken to be either inherently desirable or intimately related to our liberal democratic values.18

Exemption thus, encourages expression of constitutionally protected rights of free association. In general, there are two types of association freedoms: 1) freedom

17HOPKINS, supra note 14.

of intimate association and; 2) freedom of expressive association.\textsuperscript{19} The first has to do with personal liberty and the second with the right of free speech. The Constitution protects these rights from government intervention because they foster diversity and advance personal liberty.\textsuperscript{20}

In summary the traditional theory justifies exemption because these organizations provide important public services or mundane services to underprivileged persons and they do so in ways which are more efficient or more politically correct than if provided by government. Therefore, government should support charity through an indirect subsidy. Many presume that if charities did not provide these services, government would undertake their activities thus, they are relieving a burden of government through their activities.\textsuperscript{21} This theory has a lot going for it: it is simple; it makes logical sense; it appeals to our patriotism; and it even has tangentially a squishy element because it promotes humanitarian efforts. It does however, leave many unanswered questions.

For instance, why not just leave the production and delivery of these goods to the for-profit businesses? Perhaps, they do not want it. This gets to the “contract failure” theory examined later. In part, it has to do with the nature of the goods or services being provided. Certain constraints exist which may limit the ability of

\textsuperscript{19} HOPKINS, supra note 14, at 14.

\textsuperscript{20} Id.

government or for-profit firms to offer those goods and services so, nonprofits step in. \textsuperscript{22} But, the lines between the sectors have blurred somewhat over the last twenty years or so. Many services that were almost exclusively the domain of the nonprofit organization, for-profits now provide and vice versa. Childcare, daycare, senior care, athletic clubs, health care, the fine arts and other traditionally nonprofit activities are these days populated with for-profit firms. Similarly, many nonprofits' activities have become increasingly entrepreneurial or commercial in fact and appearance. Providing a subsidy for some of these activities and not others does not seem quite fair. Do charitable organizations provide "better" public goods; are they better at distributing mundane goods to the disenfranchised; is it more politically correct to do it this way; is it more democratic? Probably not. It appears to be simply a matter of political preference, expediency and history. Many of these traditionally exempt areas are being highly scrutinized regarding their purported charitable purpose and some suggest that they be stripped of their exemption.\textsuperscript{23}

The traditional subsidy theory does not explain enough. It cannot account for exemption for religious organizations unless, spirituality is considered a public good.

\textsuperscript{22}Id.

Subsidizing these organizations, *the* largest subset of the charitable sector, some contend to be against the Establishment Clause of the Constitution.\(^2^4\) Some commentators have suggested any subsidy to generally any charitable organization is unjustified and perhaps unconstitutional.\(^2^5\) Others suggest that exemption may not be very important to some nonprofits and may even be detrimental to some.\(^2^6\) Also questionable under the subsidy theory are exemptions accorded to public interest law firms; organizations whose sole purpose is to sue the government to compel, disrupt or prevent some action which in the sole opinion of the organization or its directors is good or bad for the general public. Other questionable exemptions are those that stretch the definition beyond its reasonable limits to allow exemption for controversial organizations like those advocating racism or radical feminism.\(^2^7\) Perhaps allowing these exemptions encourages the pluralism, liberal democratic values and diversity of opinion so greatly valued by Americans. Exemptions also encourage freedom of association. It is more likely that no real thought went into these issues prior to the granting of exemption.

The traditional theory does not take into account whether exemption is the correct form of subsidy. A broad based subsidy through the tax system has little if anything to do with the social benefits that charities offer. The government makes no effort to tie the size of the subsidy to the value of the benefits provided (assuming of

\(^{24}\) Atkinson, RESEARCH AGENDA: LEGAL ISSUES, *supra* note 1, at 15.


\(^{26}\) Webster, G., *The Mythology of Revocation*, 8TH NYU BIENNIAL CONFERENCE ON CHARITABLE FOUNDATIONS, 243, 260 (1967).

course, that the benefits’ value is subject to measurement). The subsidy theory implies that tax exemption is the only feasible, practicable, flexible and easily administered form of subsidy. In fact, some authors praise exemption for its indirectness. This argument seems to dismiss the issue of “heart” too casually. This is not to say, however, that it is wrong. It may be that exemption’s looseness is necessary and appropriate. For instance, a direct grant program would require a whole other bureaucracy to evaluate who qualified annually for subsidy, and like the National Endowment for the Arts, would be subject to political pressure and criticism for funding controversial projects. A different type of subsidy would be by necessity more active and less passive.

As a practical matter, it ... will not be feasible to condition tax exemption ... on a judgment by the Treasury Department as to whether capital investment among nonprofit firms in particular industries has exceeded the efficient level. Such a criterion would be extremely difficult to administer ... (A) more refined approach to donative nonprofits would probably not be worth the increase in ambiguity and administrative complexity it would entail. (emphasis added).

The traditional subsidy theory and several of the other theories examined below rely too heavily on economic efficiency. They presume that exemption for these organizations should only continue if these organizations are either more efficient producers of public goods than government or for-profit organizations or there is not

28HOPKINS, supra note 14, at 7.

29Hansmann, Henry, The Rationale for Exempting Nonprofit Organizations from Corporate Income Tax, in ECONOMICS OF NONPROFITS, supra note 21, at 382-383 (reprinted from 91 YALE L.J. 50, 100, (1981)).
sufficient market to support the entry of for-profit firms into similar activities. There is no empirical evidence to support this conclusion. The evidence seems instead to support the notion that exemption as a subsidy is probably unnecessary although it remains the preferred organizational structure in some functional areas such as health care:

[Why nonprofits exist is a fundamentally different question than whether they should be exempt, a point that many writings on the subject fail to recognize. Even if we were assured that the favorable view of nonprofit hospitals is accurate (and we could quantify that it produces sufficient net benefits to earn the exemption’s subsidy) . . . there is no reason a priori to believe that nonprofits would not continue to predominate absent the subsidy. Indeed there is every reason to suppose the contrary.]

Emphasis on economics ignores the way in which exempt organizations provide service (e.g., at or below cost in many instances) and ignores the pluralism, liberal democratic values, diversity and other matters of the heart that went into the creation of the organizations in the first place. Unfortunately, these matters are not subject to measurement as are economic factors (i.e., “the less tangible benefits are difficult to quantify, or inherently unquantifiable . . . ”) Without some method to measure these amorphous qualities, comparisons of charities’ achievements to those of business or government often rely too heavily upon judgment and intuition. Intuition

30Id. at 382.

31Hall, Mark A., Modern Theories of Hospital Tax Exemption, in RATIONALES, supra note 4, at 31.

32Id. at 34.
may be inappropriate for such a broad policy decision arena, particularly when courts and governmental agencies must apply complex legislation in application.

Finally, some would argue that the subsidy is not a subsidy at all. Bittker and Rahdert (see below) suggest, as do others, that the tax base excludes charities by rational choice and that exclusion from the tax base defines exemption:

Congress is not ‘giving’ such organizations any ‘benefits’; the exemption (or deduction) is not a ‘loophole’, a ‘preference’, or a ‘subsidy’ — it certainly is not an ‘indirect appropriation.’ Rather, the various Internal Revenue Code provisions comprising the tax exemption system exist basically as a reflection of the affirmative policy of American government to not inhibit by taxation the beneficial activities of qualified exempt organizations acting in community and other public interests.  

Income Definition Theory. If exemption is not a subsidy, the inefficiencies described above would be irrelevant. The income definition theory dismisses the idea that exemption is a subsidy. This theory justifies exemption by the fact primarily that there is no reasonable, equitable, or enforceable definition of taxable income for most charitable organizations. The income definition theory argues that charities’ income is not measurable in the same way that it is for for-profit enterprises and therefore, that income is excludable from taxation.

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33 Hopkins, supra note 14, at 13.

Respected tax scholars Boris Bittker and Tom Rahdert argued that legislative history indicates the reason charities escaped taxation was that logically taxation only applied to for-profit activities. They identified two primary issues used in deciding whether or not to tax charities: 1) there is no workable definition of income under the tax law, and; 2) even if there was, there is no agreement as to an appropriate rate of taxation. As to the definition of income issue, the only source of revenue in for-profit firms analogous to gifts, dues and contributions in charities are capital contributions which are not taxable. Of course, there is nothing to prevent the Congress from changing the definition of taxable income to include dues, gifts and contributions, but they have had plenty of opportunity and have chosen not to do so. Further, on the disbursement side of the income definition equation, the expenses charities incur in the accomplishment of their charitable purpose such as educational gifts and grants, or subsistence payments to disadvantaged persons have no correlation to the ordinary and necessary business expenses of the for-profits. Bittker and Rahdert argue that changing the tax definition of income to include the types of income realized by charities, requires including the types of expenditures incurred, resulting in most instances in no taxable income anyway since most nonprofits operate on a break-even

35 Id.

36Scrivner, Gary N., 100 Years of Tax Policy Changes Affecting Charitable Organizations, in, Gies, Ott and Shafritz, supra note 23, at 126.

37IRC Section 162, 274. (All references to the Code or to IRC are to the 1986 Internal Revenue Code unless otherwise stated).
basis. Thus, even if a workable definition of income could be developed there would most likely not be any significant amount of new tax revenue realized.

Similarly, there are problems in deciding upon an appropriate rate of taxation. Governments often base tax rates either upon the value of benefits received in return or on the individuals’ or corporations’ ability to pay. Some authors have suggested that nonprofits have no ability to pay. Alternatively, some suggest that the beneficiaries of most charities’ largess are the poor, disadvantaged or disenfranchised, therefore, those who would lose in any decision to tax nonprofits would be those who can least afford it.

In summary, Bittker and Rahdert infer that exemption was not a conscious policy choice among several different types of subsidies. Adoption and retention was simply a matter of simplicity, technical necessity and administrative convenience. This is not to say that their theory is not without holes or problems. Hansmann, for

38 Bittker and Rahdert, supra note 34, at 312-313. See also Slocumbe, Walter B., Charities and Federal Taxes: Issues for Analysis, in RESEARCH AGENDA: LEGAL ISSUES, supra, at 3 ([T]he great bulk of operating charities - including many of the wealthiest - show, over any period of time, no net income - at least if, consistent with normal tax principles for measuring income, current gifts are left out of account.

39 Weil, Stephen E., Excellence, Autonomy and Diversity: The Case for Tax Exempt Cultural Organizations, in RATIONALES, supra note 4, at 6 (“Rarely are they able to show even a negligible surplus or to accumulate any substantial reserves. Even without such a tax exemption, they would have little or no income available to be taxed.”). Contra, Scrivner, Gary N., Accumulations of Income by Charitable Organizations: How Much is Too Much?, TAX EXEMPT ORGANIZATIONS, 3037 (Prentice-Hall, ed., 1987) (suggests some charities may be hoarding assets and income).

40 Atkinson, RESEARCH AGENDA: LEGAL ISSUES, supra note 1, at 21.
instance, has suggested that the corporate income tax, although progressive, cannot be justified in the legislative history from an "ability to pay" standpoint.\footnote{Hansmann, in ECONOMICS OF NONPROFITS, supra note 29. See also Hansmann, RESEARCH AGENDA: LEGAL ISSUES, supra note 8, at 5.} He further suggests that "it is not obvious that the ultimate incidence of an income tax levied on nonprofits would be especially regressive."\footnote{Hansmann, in ECONOMICS OF NONPROFITS, supra, note 29.} This should result in a sharing of the burden of taxation by donors to the organization rather than passing it on to the beneficiaries. Hansmann further posits that a workable definition of taxable income for charity is fully possible. Even for charities that receive most of their income from donations "there is a natural correlate to the concept of taxable income developed for business entities."\footnote{Id.} Hansmann gives the example of paying Tiffany’s to send a wedding gift to a friend as:

\begin{quote}
[M]uch the same as if you give to the Red Cross to spend on food for a flood victim; in each case you are paying an organization to render services to a third party . . . . Thus, it seems that without much difficulty we can extend to nonprofits the general principles of tax accounting commonly applied to profit seeking firms.\footnote{Id.}
\end{quote}

While Hansmann might in many instances be correct as to the similarity in the nature of receipts between some nonprofits and forprofits, the distribution of those receipts is quite a different matter. The motivations for distribution can be quite different. That is, the motivations of the for-profit are to increase profits and ultimately to increase distributions to its owners, operators and other stakeholders.
Charities, on the other hand, are motivated presumably by issues of the heart, there is no expectation of material benefit on the part of the contributor, and the charity is prohibited by the nondistribution constraint of the exemption statute from making distributions of net profits to private stakeholders. What this points out is that while it might be possible to come up with a workable definition of taxable income for nonprofits, it might not be appropriate.

It is also clear, that many charities serve neither the disadvantaged or disenfranchised. For instance, many arts organizations serve a predominately affluent population. Hansmann argued that organizations (such as the Metropolitan Opera of New York), although providing a public service, provide that service only to a small and particularly wealthy population group.\textsuperscript{45} Providing a broad subsidy to this type of organization in effect requires all socioeconomic groups of the population to pay for a service only used by the wealthy.\textsuperscript{46} It is not possible to justify such a subsidy in law or equity just because there are difficulties developing a workable definition of taxable income. Certainly, many would argue that "the arts do, in fact, make an important contribution to our public life ..."\textsuperscript{47} but the fact remains that this is a clear instance of the poor and middle class subsidizing a "public service" for the rich. Similarly, Hansmann points out that many educational organizations (particularly private higher educational institutions) are unjustly subsidized by exemptions, while patronized by the well-to-do.


\textsuperscript{46}Feld, O'Hare and Schuster, \textit{Patrons Despite Themselves: Taxpayers and Arts Policy}, (N. Y. U. Press, 1983).

\textsuperscript{47}Weil, \textit{in Rationales, supra} note 39, at 9.
Another criticism of the income definition theory is that the tax law does not accord the same treatment to all nonprofit organizations. For instance, political organizations are exempt from income tax, they receive contributions and gifts, yet the contributions are not tax deductible by the giver as they are for gifts to charity.\(^48\) There are other nonprofit organizations whose primary source of income is not donations but sales of goods and services. In addition, their expenditures are very similar to for-profit business, but taxation does not apply because their activities are charitable in nature or undertaken primarily for charitable purposes or as mutual benefit societies or cooperatives. Examples of this type of organization include hospitals, cooperative utilities and other cooperatives, mutual insurance companies, farm bureaus, etc. It is difficult to justify exemption on the lack of a workable definition of income for these organizations:

(C)an purely commercial nonprofits be charitable? \ldots My own view is that, whether or not we decide that commercial nonprofits such as hospitals and health maintenance organizations should be provided tax exemption, we should not stretch the concept of charity to cover them. Rather we should consider as charities only those organizations that truly produce public goods.\(^49\)

The rationale offered by Bittker and Rahdert in their income definition theory can at least on a technical basis, be rebutted. "Exemption is not a matter of technical necessity. It could be eliminated without doing violence to the structure of the tax system, and therefore its retention requires a substantive, not merely a formal,

\(^{48}\)Hansmann, \textit{in} \textit{RESEARCH AGENDA: LEGAL ISSUES}, \textit{supra} note 8, at 8.

\(^{49}\)\textit{Id.} at 10.
justification." A 1987 study of nonprofit hospital chains indicates hospitals do not provide sufficient charity care to justify their exemptions. The study suggested further that the poor would probably have benefited more if the nonprofit hospitals had paid tax on their considerable profits and had that tax revenue used to provide health insurance or services for the poor. Although it would require a certain degree of complexity, it is possible to come up with workable definitions of taxable income for nonprofits. Complexity, even untidiness, is nothing new to the tax law.

However, just because it's possible to develop workable definitions, does not mean it's appropriate. What then is unique about nonprofits that justify exemption? Is there a normative justification rather than just a technical or economic one? Part of the difficulty with these questions is that the "asserted virtues of charity are difficult to prove." However, that does not mean those virtues are any less important to developing a rationale for exemption.

The Contract Failure/Capital Formation Theory. The concept of "contract failure/capital formation" emphasizes that nonprofit organizations are limited, perhaps unnecessarily so, by their inability to sell bonds or issue stock to raise funds for operations in the same way that many for-profit concerns do. This theory presumes that tax exemption may help mitigate that problem by allowing nonprofits to retain

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50 Atkinson, in RESEARCH AGENDA: LEGAL ISSUES, supra note 1, at 28.


52 Bittker and Rahdert, supra note 34, at 331-332.
excess funds from operations to support further operations. Exemption thus, helps nonprofits accumulate the capital they need to respond to public demand for services for-profit organizations have not approached due to contract failure. Exemption helps to offset a perceived disadvantage nonprofits have in attracting capital. Exemption encourages a more efficient allocation of resources.

Contract failure refers specifically to economic theory dealing with market forces that assume consumers know what they want, they know when they have received good value for their money, and competition assures they paid the lowest price. Without these conditions, contract failure ensues. "(N)onprofit enterprise is a reasonable response to a particular kind of 'market failure', specifically the inability to police producers by ordinary contractual devices . . . ."

Hansmann has described three primary forms of contract failure. The first has to do with those organizations that provide relief to the needy. It results when there is a "separation between the purchaser and the recipient of the service." This can refer to a geographical or economic separation such that it would be difficult for

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53 Hansmann, in RESEARCH AGENDA: LEGAL ISSUES, supra note 8, at 5. See also Hansmann, in ECONOMICS OF NONPROFITS, supra, note 29.

54 Atkinson, in RATIONALES, supra note 4, at 29.

55 Hansmann, supra note 45. See also Hansmann, in ECONOMICS OF NONPROFITS, supra note 29. (Hansmann suggests at least two other forms of contract failure: voluntary price discrimination and implicit loans which he admits (at 69) are not essential to the theory and which may detract).

56 Hansmann, in ECONOMICS OF NONPROFITS, supra note 29, at 63.

57 Id. at 63-64.
the purchaser of the service (the donee in the case of a nonprofit organization) to evaluate whether the service is in fact provided to the needy in the most beneficial ways. Forprofit firms providing the same service could skimp on the service in the interest of increasing profits for distribution to shareholders and the purchaser would be none the wiser. But, because nonprofits provide these types of services and have exclusivity and nondistribution constraints, there is no incentive to skimp. Examples of this type of organization include the American Red Cross, CARE, UNICEF, the Christian Children's Fund and others.

The second primary form of contract failure occurs when for-profit firms provide a public service but the demand exceeds the supply. Nonprofit organizations then spring up to fill the gap in supply. This form often involves a service that cannot exclude those who do not wish to share in the cost. Many museums, public radio and television, and other arts organizations provide their services to the public at large without any mechanism to limit their service to only those willing and able to pay for it. Certainly, there are those who agree radio or television without commercials, with educational and more arts oriented programming is valuable and are willing to donate to nonprofits providing such services. Hansmann suggests they would not donate to a for-profit firm offering these same services because they have no way to assure their donation went to enhance programming rather than to enhance net profits. Thus, nonprofits are the preferred providers of these services due primarily to the nondistribution constraint and exclusivity requirement.

\[58\] \textit{id.} at 66.
The third form of contract failure occurs when providing "complex personal services." These are services that are so technical, complex, or esoteric that, even though the purchaser is the one receiving the service, it is extremely difficult for them to evaluate the quality as compared to the cost. Examples of these services might include many forms of health care and higher education. When purchasing these services from a for-profit or governmental provider, consumers often worry whether their next dollar is really going to improved service or to profits or bureaucracy. Consumers may often be more comfortable purchasing these services from a private nonprofit due to a lack of trust in governmental services and concerns over for-profit companies profiting from people's ignorance or misery. Because of the nondistribution constraint and exclusivity requirement, the private nonprofit presumably more often has the consumer's needs at heart.

It is important to note that in all three primary forms of contract failure, Hansmann emphasizes nondistribution constraint as the essential characteristic for success (interestingly he includes the exclusivity requirement under the heading of nondistribution constraint without separately identifying it). This points out the normative aspects of what would otherwise be a rather straight forward economic

59 Id. at 70-71.


61 Krashinsky, Michael, Transaction Costs and a Theory of the Nonprofit Organization, in ECONOMICS OF NONPROFITS, supra, note 21, at 114, 132 ("Consumers prefer nonprofits because that is the only way to be sure that contributions advance the stated goals of the organization rather than just increasing the profits of entrepreneurs.").
theory. This essential characteristic provides the public with assurance that their funds go for service enhancement rather than profit and distribution enhancement.

Empirical studies into Hansmann's theory come down both for and against certain aspects. For instance, Perlmut has suggested there is no conclusive evidence that the third type of contract failure (the complex goods form) can account for consumers' preference for nonprofits.62 Other authors support Hansmann's idea that capital formation is an appropriate justification for exemption without reference to any one type of contract failure (i.e., "the fundamental differences between nonprofit and for profit organizations does not turn so much on intrinsic differences in organizational form or capability, or even on legal criteria . . . as on differences in the availability of resources and constraints associated with their acquisition.")63 Still others agree that contract failure can stimulate the formation of nonprofit organizations even when providing mixed public/private goods.64

Hansmann himself is the first to criticize his theory particularly as it relates to justifying exemption for commercial nonprofits. He readily admits that tax exemption


63 Powell and Friedkin, Organizational Change in Nonprofit Organizations, in THE NONPROFIT SECTOR: A RESEARCH HANDBOOK, (Powell, Walter W., ed., 1987). See also Weisbrod, Burton and Schlesinger, Mark, Public, Private, Nonprofit Ownership and the Response to Asymmetric Information: The Case of Nursing Homes, in ECONOMICS OF NONPROFITS, supra, note 21, at 133.

is an “extremely crude mechanism” for dealing with the capital formation problem. Even further, he posits:

But what kind of market failure are the nonprofit organizations . . . responding to? One possibility is that they’re responding to problems of asymmetric information, or ‘contract failure,’ with respect to their customers. That is, the nonprofits . . . might serve as fiduciaries for their customers in situations where the latter are in a poor position to look out for themselves. But . . . it is not at all clear that . . . nonprofit organizations . . . in fact play this role in any important way. Moreover, even if they did this would not in itself provide grounds for tax exemption . . . . Something more is needed to justify exemption.

I have argued . . . that the best candidate for this ‘something else’ is that nonprofit organizations may be inefficiently constrained in their ability to raise capital, and that tax exemption can help compensate for (or at least avoid aggravating) this problem . . . . While this may be the best argument for exempting ‘commercial’ nonprofits from corporate income taxation, it is nevertheless a very tenuous argument. Indeed, not only is it arguable that most exempt commercial nonprofits do not serve an important function as a response to contract failure, but what is more they are often arguably overcapitalized as well. Thus they fail to satisfy either of the elements of the justification for exemption just described. 65

It may further be possible to criticize Hansmann’s theory for its reliance upon economic efficiency as the sole justification for exemption without recognition of the possibility of other factors which might “justify the exemption subsidy on broader grounds.” 66 The theory presumes consumers’ only interest is in maximizing their

65 Hansmann, in RESEARCH AGENDA: LEGAL ISSUES, supra note 8, at 5-6.

66 Atkinson, in RATIONALES, supra note 4, at 29.
marginal utility from which follows optimal production levels and a balance between
the sectors. This is very likely to be incorrect. The theory further presumes that
nonprofits will in fact use excess profits for service enhancement. While it is logical to
assume that due the nondistribution constraint there is less incentive for nonprofits to
realize substantial operating surpluses and to use those surpluses for other than their
charitable purpose, the current crisis of confidence stems from a few highly publicized
cases where just that type of problem might have occurred.

Minor Theories

The Donative Theory. Perhaps a better phrase than “minor theories” would be
“other theories.” However, many of these other theories take their cue from one of
the three major theories discussed above and simply expand thereon. Thus, they
constitute minor theories; variations on the theme. The first of these is the donative
theory, which takes Hansmann’s economically efficient capital formation theory one
step further. The suggestion that contributors will only buy as much goods or services
as they want or need may be untrue, at least for donative nonprofits. That suggestion
may hold true for commercial nonprofits (those that sell public goods or services such
as health care or education), but not for donative nonprofits (those that rely on
contributors to “buy” goods or services for strangers or for the public at large). This
theory supports subsidization because chronic undercapitalization of those donative
nonprofits exists and therefore, it is economically efficient to promote their activities
through a broad tax subsidy. Hansmann suggested it is likely undercapitalization exists

67 Hall, Mark A., and Columbo, John D., The Charitable Status of Nonprofit
Hospitals: Toward a Donative Theory of Tax Exemption, 66 WASHINGTON L. R. 328-
in all donative nonprofits, yet he may tend to ignore any data to the contrary.\textsuperscript{68} Hansmann also suggested that as a criterion for determining exempt status, undercapitalization is not administratively feasible.\textsuperscript{69} Donative theory requires that donative nonprofits continue to realize at least one third of their income from donations, a criteria which would eliminate exemption for private foundations, heavily fee oriented charities, and well endowed organizations who realize substantial investment income.\textsuperscript{70} Thus, the donative theory would eliminate exemption for commercial nonprofits as well.

In summary, organizations providing public goods or services at or below cost financed primarily by donations are considered worthy of an exemption subsidy. Commercial nonprofits, regardless of the complex nature of their goods or services, or the public’s ability to evaluate their quality, are not worthy unless donations similarly finance their services in large part.\textsuperscript{71}

**Altruism Theory.** This theory relies less upon economic efficiency and more upon where the funding came from to finance an organization’s activities. It is a somewhat fine distinction from the donative theory, but nonetheless it emphasizes how

\textsuperscript{68}Hansmann, in \textit{ECONOMICS OF NONPROFITS}, \textit{supra}, note 29.

\textsuperscript{69}\textit{Id}.

\textsuperscript{70}Atkinson, in \textit{RATIONALES}, \textit{supra} note 4, at 39.

\textsuperscript{71}Bennett, James and Rudney, Gabriel, \textit{A Commerciality Test to Resolve the Commercial Nonprofit Issue}, 36 \textit{TAX NOTES} 1095, 1097-98, (1987) (suggests taxing all nonprofits who sell goods and services unless 50% of the cost of production is paid with donated dollars and the service is “directed at a specific recipient group or purpose deemed charitable.”).
capital gets into these organizations. When realizing funding from the public at large without any expectation of benefit or financial return, an altruistic benefit ensues; a benefit to the public at large rather than to individual stakeholders. As the organization operates their earnings similarly go toward producing public benefits and perpetuation of the altruistic purpose in forming and capitalizing the organization in the first place occurs. It is this ongoing public benefit that justifies exemption (e.g., "altruistic supply of a good or service—any good or service—is a metabenefit worthy of consideration for tax preference . . .").

Some say that charity promotes economic efficiency but there are no empirical tests of this theory and perhaps could not be. Theoretically, charity also supports the liberal democratic values and freedoms Americans so readily espouse as essential to society. This too, cannot be supported empirically. Efficiency, however, is not necessarily the only criterion for evaluating public benefit.

**Transaction Costs Theory.** This theory suggests justifying the nonprofit exemption not so much because of market failures by government and for profit organizations, but rather due to the "relative advantages" of nonprofit organizations in overcoming a variety of factors called "transaction costs." In general, transaction costs are the costs incurred (both real and opportunity costs) "in the process of transforming inputs into utility." There are three types of transaction costs: costs

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73 Id.

74 Krashinsky, *in ECONOMICS OF NONPROFITS*, *supra* note 61, at 114.

75 Id.
among producers; costs between producers and consumers; and costs between consumers. Supposedly, for-profit firms are particularly adept in planning for and dealing with the first type while the other types are unusual and require the kind of special treatment only a nonprofit organization can provide.

The nondistribution constraint is a type of contract ("a standard contract") between nonprofit firms and consumers that consumers can rely on to reduce transaction costs between producers and consumers. Similarly, the broad nature of the exemption subsidy and the government's minimal efforts to enforce the exemption statute further reduce transaction costs. Nonprofit organizations are a natural evolution of a variety of attempts to control high transaction costs particularly where there are questions about the quality of complex services. This both supports and acknowledges Hansmann's contract failure theory. "Hansmann . . . in one of the best 'market failure' approaches to the nonprofit sector, argues that this difficulty in monitoring quality is at the root of the existence of the nonprofit sector. That of course is true, since the contracting problems explain the existence of all organizations."

This theory suggests the formation of nonprofit organizations occurs when individuals perceive the transaction costs (i.e. regulation; access; lobbying costs; dealing with the political system; issues of morality; or individual freedoms) involved in having government or business provide the desired services are too high.

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76 Id.

77 Id. at 116 (footnote omitted).

78 Id. at 126.
Government cannot be all things to all people, and the free market economy cannot address every service need.

**Other Thoughts About Theory**

The above discussion is not all inclusive; there are other theories for rationalizing exemption (e.g. Weisbrod⁷⁹; Legorreta and Young⁸⁰; and Hall⁸¹) which have not been included in the interest of time, space and economy of explanation. There is a problem with any broad theory; that it is a broad theory.

(A)ll flirt shamelessly with the fallacy of the one true way. To borrow a phrase from Hall and Colombo, we are looking for ‘bright line mathematical tests’. In so doing, we may be guilty of murdering to dissect, of basing our exemption theories on a cadaver of our own creation rather than on the flesh and blood charities that populate the real world... When we Grand Theorists force the body of charity into the... bed of single variant theories, we are tempted to leave out aspects that do not readily fit... this danger of distortion carries with it a second danger; in failing to account for these aspects of charity, we may be weakening the political case for the exemption of a more or less wide array of organizations we are ready to accept, from a more synoptic perspective, as charitable.⁸²

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⁸¹ Hall, *in RATIONALES, supra* note 31, at C.

The problem of rationalizing tax exemption is "both scholarly and applied." Neither theory nor application can provide a complete picture, nor can one be relied upon too heavily to the exclusion of the other. What can be done is to look back at the theory for common criteria by which to judge the application of present law. The sole criterion common to all the theories, major and minor alike, is the normative aspect. Each of the theories in some way admitted that charity is about matters of the heart; about selfless love for others. Several of the theories in large part embodied this common criterion in the nondistribution constraint and to a lesser degree in the exclusivity requirement of the exemption statute (although not often described as such). So let's see how this normative aspect plays out in the exemption statute.

The Essence of Exemption

The Concept of "Exclusivity"

Introduction. The exemption statute for charitable organizations has existed in substantially the same form, except for minor changes, since the Revenue Act of 1913. It includes one positive action the nonprofit organization is to take and two prohibitions. The positive action requires that organizations operate exclusively for one or more charitable purposes. The statute and regulations covering exemption for charitable organizations have consistently "been construed as requiring all the

83 Van Til, supra note 7, at 170.

84 Scrivner, in Gies, Ott and Shafritz, supra note 23, at 127.

85 IRC Section 501(c)(3).
resources of the organization [other than an insubstantial part] to be applied to the pursuit of one or more exempt purposes." The organization must therefore, consistently put their charitable goals into practice.

An organization will fail in practice and lose that favored tax status if it there is any substantial deviation from the exempt purpose for which exempt status was granted; it carries on substantial unrelated activities; it engages in substantial lobbying activity; or, it allows any part of its net earnings to inure to the benefit of any private individual. The first three of these deal with the exclusivity requirement of the statute and the last with the nondistribution constraint. This latter issue will be returned to later. Despite the fact the statute says exclusively, the courts and the IRS have consistently interpreted that phrase to mean "substantially" or "primarily," rather than "only" or "solely." Engaging in nonexempt, unrelated or unapproved activity generally will not adversely affect an organization’s continuing qualification for exemption if it is "only incidental and less than substantial." The regulations require that all substantial activities of an organization bear a direct causal relationship to the accomplishment of the charitable purpose.


87Scrivner, Gary N. and Callaghan, Christopher T., A Path to Self Sufficiency, PHILANTHROPY MONTHLY, September, 1980, at 17.

88See Treas. Reg. Section 1.501 (c)(3)-1(c)(1).


90Treas. Reg. Section 1.513-1(d)(1) and (2). See also Scrivner, supra note 39, at 3038.
There are great difficulties in applying the exclusivity test primarily due to the ambiguity of the terms used to define it. There are numerous decisions based primarily on the exclusivity issue however, despite these difficulties.\textsuperscript{91} In order to understand the contemporary application of the concept one must first understand its components and its history.

While the exemption statute has remained substantially unchanged since 1913, major changes occurred in 1950 and 1954 to redefine the relatedness requirement for any charitable activity.\textsuperscript{92} Prior to the 1950 Tax Act, all income received by an exempt organization escaped taxation and the activity was considered related if the income supported exclusively exempt purposes, even if the nature of the activity generating the income was wholly unrelated to the exempt purpose. This was the “destination of income” rule, a precedent set by the Supreme Court in 1924 in \textit{Trinidad v. Sagrada Orden de Predicadores}.\textsuperscript{93} Perhaps the best known story about abuse is that of the Mueller Company, a profitable macaroni manufacturing company owned and operated by New York University. Of course, the IRS took exception to what they perceived as an obvious scheme to avoid taxes. The IRS lost its case, but by the time the Third Circuit Court of Appeals rendered its decision in 1951, Congress changed the law.\textsuperscript{94}

\textsuperscript{91}e.g. Smith v. U.S., 84-2 USTC 13595, (W.D. Mo. 1984); Copyright Clearance Center v. Commissioner, 79 TC 793,805 (1982); Bethel Conservative Mennonite Church v. Commissioner, 80 TC 352 (1983), rev’d 746 F.2d 388 (7th Cir. 1984).

\textsuperscript{92}Scrivner, in Gies, Ott and Shafritz, \textit{supra} note 23, at 126.

\textsuperscript{93}263 U.S. 578 (1924).

\textsuperscript{94}C.F. Mueller Co. v. Commissioner, 190 F.2d 120 (1951). But cf., Rose-Ackerman, in Gies, Ott and Shafritz, \textit{supra} note 23, at 91-108 (This decision remains the subject of some debate; e.g. “[L]ook beyond the organization . . . [w]hy must a fair
Of primary concern (the essence of exclusivity) is whether an activity is substantially related which depends upon whether there exists a causal relationship between the activity and the organization’s exempt purpose.95 The issues of substantiability and causal relationship are under some scrutiny at this time. One author has suggested that the concept of exclusivity as a whole is declining in importance to the finding of exempt status.96 The courts have found in a number of instances that organizations qualified for exempt status despite the presence of substantial noncharitable purposes, however, as a matter of policy these organizations retained their status because their charitable purpose outweighed their noncharitable one.97

The IRS does not support this looser interpretation and has begun to seek the assistance of the legislature in setting alternative tests. One of the most controversial proposals for new legislation currently under consideration is the redefinition, modification or elimination of the substantially related test of the statute. Substitution of an “inherently commercial” test would extend to certain activities considered per se unrelated such as the sale of goods and services. This would involve both decisions involving taxation of the related income and continued qualification for exemption depending upon the size and extent of the commercial activity. The Congressional subcommittee considering this issue was also considering recommending a “directly related” test to replace the substantially related test. Under this proposal, only income
tax code treat students and scholars who are the beneficiaries of Mueller’s profits as if they were ‘equal to’ Ronzoni’s investors?”).

95Treas. Reg. Section 1.513-1 (d) (2).

96HOPKINS, supra note 14, at 230.

97e.g., Monterey Public Parking v. U.S., 431 F.2d 175 (9th Cir. 1973).
from directly related activities would escape taxation and be excluded from exemption determinations. In an April 15, 1989, letter from Assistant Treasury Secretary, O. Donaldson Chapoton argued that a directly related test would “wreak administrative havoc among exempt organizations, and possibly, within the Internal Revenue Service.” 98 He suggested that such a basic change in the structure of the statute could have an adverse affect upon existing legitimate activities and would require a complete “reexamination of all activities currently considered to be substantially related.” 99 Chapoton reminded the subcommittee that although the definition of substantially related is murky at best, the distinction between existing law and “directly related [is] . . . not at all clear.” 100 Chapoton was not the only one to write the subcommittee about their opposition to the proposed options. In fact, the outcry against the proposal was enormous, with over 300 letters from various tax-exempt and other groups. 101

Similarly, Chapoton dismissed the “inherently commercial” concept as unclear and requiring a complete review of exempt organization activity. A group of economists first submitted this test to the subcommittee as their justification for a fundamental policy change. 102 However, little, if any, statistical support for their


99 Id.

100 Id.


102 Bennett and Rudney, supra note 71, at 1095-1098.
contentions regarding widespread competition by nonprofits was available. Their rationale were tied to the supposed inefficiency of the substantially related test and included eight reasons that test is unacceptable:

- The relatedness test does not provide for equal treatment under the law;

- The relatedness test created public controversy about the competitive advantage nonprofits enjoy in the marketplace;

- The relatedness test provides little or no effective limits upon income producing activities of exempt organizations;

- Exemption of income producing activities cannot be justified merely because the current commercial activities based upon past research, innovation, experimentation, or practice of a nonprofit institution, nor is it justified by participation in an evolving market or industry if in the past no market or industry existed, and nonprofits provided the services;

- Exemption of related income producing activities creates inefficiencies which are not beneficial to the economy (i.e. nonprofit management is less efficient; it overinvests and creates excess capacity, and as a result, many nonprofits have excessive borrowing and interest costs, which increases the risk of loss of funds intended for charitable use);
• The ambiguity of the relatedness test has created serious compliance and enforcement problems and cannot be amended in such a way as to make it sufficiently effective in improving compliance and enforcement;

• The relatedness test tends to encourage commercialism, obviates the need for fundraising by publicly supported organizations, and thus, threatens the basic values of philanthropy and charitable missions; and

• In times past, forprofit business did not or could not provide certain goods and services only available by government subsidization through tax exemption.103

There is at least some merit to these arguments. Despite that fact, in June, 1987, IRS Commissioner Lawrence Gibbs told the subcommittee he did not want a piecemeal approach to amending these statutes. Yet, in testimony to the subcommittee on May 9, 1989, Chapoton made it clear that the Treasury Department does not want a major overhaul of the exemption or unrelated income statutes either. Chapoton sharply criticized proposed fundamental changes to the substantially related test.104 A closer examination of the definition of substantially related will provide additional insight into just why this term is problematic.

103Id.

104Id.
Substantially Related Defined.

“When I use a word,” Humpty Dumpty said, in a rather scornful tone, “it means just what I choose it to mean--neither more nor less.”

“The question is,” said Alice, “whether you can make words mean so many different things.”

“The question is,” said Humpty Dumpty, “which is to be master--that’s all.” 105

It seems that with respect to the term “substantially,” Treasury sounds a great deal like Humpty Dumpty. Yet, Treasury expects us to understand and apply this term in a variety of settings (e.g., “if a writer chooses to produce a whole book in which black means white and the reverse, it is the responsibility of the reader to adapt” 106). There are no specific definitions of this term in any tax statute or Treasury Regulation and it has a variety of meanings depending upon the tax issues involved. For example, in defining a personal service corporation, the Temporary Regulations under Section 441 define “substantially” as 10 percent or more. 107 In questions of investment credit recapture when one’s ownership interest changes, the courts have held 21 percent to be “insubstantial.” 108


107 Boley and Brenneman, supra, note 105.

Lobbying expenditures of 20 percent of total expenditures can in some circumstances be considered "insubstantial." Internal Revenue Service Revenue Procedure 71-17 generally provides that for purposes of determining whether income is member or nonmember income, if an event is 75 percent attended by members, then "substantially all" attendees are members. And, in the Waco Lodge case dealing with the volunteer exception to the unrelated business income tax, volunteer services constituted only 79 percent of the total, and that was "not substantially all."

Perhaps some of the confusion about just what "substantially related" means is now more apparent. The Regulations are of some assistance, but they may also add to the confusion:

The presence of this requirement [i.e. substantially related] necessitates an examination of the relationship between the business activities which generate the particular income in question—the activities, that is, of producing or distributing the goods or performing the services involved—and the accomplishment of the organization's exempt purposes . . . . [A] trade or business is 'related' to exempt purposes, in the relevant sense, only where the conduct of the business activities has a causal relationship to the achievement of exempt purposes (other than through the production of income); and it is 'substantially related' . . . only if the causal relationship is a substantial one. Thus, for the conduct of a trade or business . . . to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services . . . must contribute importantly to the accomplishment of those purposes . . . . Whether activities . . . contribute importantly to

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109 See IRC Section 501(h) and 4911.

110 1971-1 CB 683.

111 CA-5, 83-1 USTC 9165.
the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances involved.112 (emphasis added).

Thus, in order to be substantially related an activity must bear a causal relationship to exempt purposes, and that relationship must be a substantial one; that is, it must contribute importantly to the exempt purposes. Accomplishment of an exempt purpose should be the primary purpose of any purportedly substantially related activity. All of these terms present difficult definitional problems and the Service has declined to provide direct and objective definitions for them, relying instead upon the facts and circumstances of each individual case, an equally problematic phrase. It is obviously difficult to measure progress toward accomplishment of some of the broader charitable purposes such as health and fitness; care for the ill or needy or assistance to youth. Thus, the “contributes importantly” standard may be no more objective than “substantial.” The key appears to be the relationship between the activity and the exempt purpose and whether it provides an appearance of progress toward accomplishment.

This leads us to examine the few examples provided by the Regulations113 and the case law in an effort to obtain a better understanding of this causal relationship standard. Existing Regulations, and many legal precedents, provide guidance only when the facts and circumstances are substantially similar to the case described therein. Therefore, they may be of limited use and benefit. Legal precedent can, however, sometimes provide more broadly applicable rules appropriate to interpretation of many

112 Treas. Reg. Section 1.513-1 (d) (1) and (2).

113 Treas. Reg. Section 1.513-1 (d) (4).
different factual situations. For instance, in *Carolinas Farm & Power Equipment Dealers Ass’n, Inc. v. U.S.* the Tax court identified three factors relevant to the resolution of the substantially related issue:

1) whether fees charged for the goods or services provided are directly proportionate to the value of the goods or services received;

2) whether sales or participation is limited to a particular class of individuals and thus, is of no benefit to persons outside that class; and

3) whether the goods or services provided are ones commonly available from or furnished by forprofit entities.\(^{114}\)

Of these three, the third is perhaps the most significant. That is, where a service is available in the marketplace, it is unlikely (but possible) the provision of that service is essential to the accomplishment of an exempt purpose. *Carolinas' Farm* made that point as did *Associated Master Barbers & Beauticians of America, Inc. v. Comm.* where the organization’s primary purpose was to provide insurance and supplies to members and thus, the organization had no exempt purpose.\(^{115}\) However, the high degree of commercialization of an activity or its competitiveness with forprofit entities is not necessarily determinative of an unrelated purpose.\(^{116}\)

\(^{114}\) CA-4, 83-1 USTC 9161.

\(^{115}\) 69 TC 53, 64 (1977).

\(^{116}\) Clarence La Belle Post 217, V. F. W. v. U.S., 580 F.2d. 270 (8th Cir.).
The courts have applied the somewhat more objective causal relationship standard provided by *Carolinas Farm* in a number of cases primarily dealing with noncharitable, but exempt professional associations or business leagues. For example, in *Steamship Trade Association of Baltimore*, each of the three categories above applied to various insurance programs conducted by the Association; the activities represented services to individual members, the benefits of the service did not accrue to the industry as a whole, were at arm’s length rates and could have been obtained from forprofit vendors, thus the organization forfeited its exemption.\(^\text{117}\)

Other causal relationship standards exist to deal with other factual situations. The Income Tax Regulations include under the heading “Type of Relationship Required” a subheading dealing with the “Size and Extent of Activities”:

In determining whether activities contribute importantly to the accomplishment of an exempt purpose, the size and extent of the activities involved must be considered in relation to the nature and extent of the exempt function which they purport to serve. Thus, where income is realized by an exempt organization from activities which are in part related to the performance of its exempt functions, but which are conducted on a larger scale than is reasonably necessary for performance of such functions, the gross income attributable to the portion of the activities in excess of the needs of exempt functions constitutes gross income from the conduct of unrelated trade or business. Such income is not derived from the production or distribution of goods or the performance of services which contribute importantly to the accomplishment of any exempt purpose of the organization.\(^\text{118}\)

\(^{117}\) CA-4, 85-1 USTC 9291.

\(^{118}\) Treas. Reg. Section 1.513-1 (d) (3).
The courts have broadly interpreted the size and extent test and applied it to various activities. For instance, the relationship of the size and extent of retail grocery sales to the accomplishment of the exempt purpose of rehabilitating emotionally disturbed adolescents was an issue in Revenue Ruling 76-94.\textsuperscript{119} The court found that running a retail grocery store was therapeutic and the scale of the activity was consistent with the accomplishment of this therapeutic purpose. Presumably, conducting the activity in a large scale commercial manner would make it unrelated regardless of its therapeutic benefit. This test involves comparing the activity in question with similar commercial and noncommercial activities as to size and scope to determine relatedness.

A third type of causal relationship test arose out of the "trade or business" requirement in the definition of taxable unrelated business income. Within that requirement is the concept that merely conducting an activity within a larger aggregate of exempt activities, does not alter its character as a trade or business.\textsuperscript{120} The Service expanded this concept to provide for a piecemeal evaluation of relatedness for certain activities. The rulings dealing with gift shop sales by museums easily illustrate this expansion. For instance, in Revenue Ruling 73-105, the Service held that examining a museum's sales of each particular line of books permits separate determinations of relatedness. Sales of books about the items on display or about similar items the Service considered related. Sales of books about the city where the museum was located, the Service considered unrelated. "[T]he fact that some of these items could in a different context be held related to the exempt educational purpose of some other

\textsuperscript{119}1976-1 CB 171.

\textsuperscript{120}'Treas. Reg. Section 1.513-1 (b).
educational organization does not change the conclusion that in the context they do not contribute to the accomplishment of this organization's exempt educational purpose." 121

Similarly, in Private Letter Ruling 8252011, sales of T-shirts, caps, as well as jewelry, umbrellas, scarves, etc., depicting zoo animals were taxable sales since the primary purpose of these sales was "trivial" in nature (i.e. to produce income) and thus, did not relate to the zoo's primary purpose. Merely placing realistic depictions of the animals on these items was considered insufficient to alter the purpose of the sale. Sale of animal puzzles, stuffed animals and other animal toys did relate to the educational purpose being served and thus, was not taxable. The Service held that the souvenir aspect of these sales was incidental to the educational purpose. Private Letter Ruling 8303013 also dealt with these issues:

In order to determine if there is a nexus between a particular item and the achievement of B's educational purpose, the focus of inquiry must be directed to the nature, scope and motivation for the activities of the exempt organization. The fact that B's activities are very commercialized or in competition with taxpaying entities such as department and book stores is not determinative of the relatedness of the activity . . . . There should be focus on the primary purpose for the production and sale of each item. If, for example, the primary purpose of the article is utilitarian, ornamental, or a souvenir in nature, it should not be considered substantially related . . . .

This ruling, although directed to the specific organization who requested it, provides some guidance on the causal relationship tests as applied by the Service. A three part test is therefore, used to evaluate whether the activity contributes

121 1973-1 CB 263.
importantly to an exempt purpose; that is, an examination of the nature, scope and motivation of each activity. For instance, merely placing an organization’s highly recognizable logo on a coffee mug is insufficient to alter its character from commercial to noncommercial; the true nature of the item as utilitarian is unaltered. This test and others described above aren’t much more objective than the statute itself and thus, may be of limited utility. It is entirely possible that the real meaning of “causal relationship” in the statute is merely a strong correlation between the activity and the exempt purpose. The reasons for this statement are many including a lack of concrete standards by which to judge relationships, the difficulty with comparing this test with other causal relationship standards, and perhaps, because there are no variables to be manipulated; that is the possibility the activity has nothing to do with the achievement of the organization’s purpose. One commentator suggests that the latter question of whether an organization can achieve its purpose without any one of its current or planned activities is one the IRS addresses in making unrelated business income tax determinations and one an organization’s Board should consider periodically.¹²²

What makes the application of a causal relationship test so difficult are the innumerable activities or factors which together contribute importantly to the accomplishment of the exempt purpose without any one activity contributing significantly or contributing significantly more than any other. And, it may be difficult on a test basis to eliminate any activity in order to make observations of the effects of such elimination, particularly when providing human services. There may also be ethical questions inherent in decisions to curtail certain activities which make that action unconscionable. While many of the rules and rulings discussed above relate

¹²²Scrivner and Callaghan, supra note 87.
directly to the unrelated business income tax they also bear on whether an organization meets the operational test of the exemption statute, most specifically the exclusivity requirement.

Other Legal Models of Causality. Because these are essentially legal questions, perhaps other legal models will display more promise for substitution. Causal questions appear in nearly every branch of the law. Causal questions arise in the law, for instance, in proving the “rule against perpetuities.” The rule against perpetuities is a proof of law dealing with the validity or invalidity of an interest in trust: “[t]he task is to prove that an interest will vest or fail within 21 years after the death of some person now alive. If you can find that person, such person is the validating life—the person who enables you to make the proof required to validate the interest.”

For instance, assume a person executes a will devising all their property in trust to their spouse with the remainder to nieces and nephews. Later, the testator executes a codicil to the will terminating the spouse’s interest if they remarry anyone but another natural-born citizen of the US, and providing that upon the spouse’s death the remainder shall go to those nieces and nephews living then or born at a subsequent time who should attain the age of 21. Whether the codicil is valid or void depends upon the existence of certain causally related persons. This group of persons includes every relationship that any validating life bears to vesting under any of the stated limitations. An interest in the trust will vest if owned by an ascertainable person, is not subject to a condition precedent, the class of persons is closed, and all conditions

precedent for every member of the class have been satisfied. In this instance, the class of persons is not closed if the testator’s parents and/or brothers and sisters are still alive at their death. Therefore, the codicil is invalid. The related lives examined always include the beneficiaries, any person that can affect the identity of the beneficiary, and any person that can affect a condition precedent.\(^{124}\)

While these rules might work well in resolving disputes over difficult and ambiguous questions of trust law, they do not appear to be adaptable to relatedness or exemption questions. These rules apply to human lives and, therefore, do not help in evaluating relationships between activities and purposes. In addition, few legal scholars understand these rules, much less, lay persons.\(^{125}\)

Much of the legal literature deals with causation in the tort of negligence. One such popular standard is the “but for” test: “[t]he ‘but for’ test has been prescribed as an adequate criterion of causation for most cases. This test asserts that whether a given event, A, is a cause of another event, B, can be determined by asking (and answering) the question: ‘But for A, would B have happened?’”\(^{126}\)

\(^{124}\)Iid. at 252-253.

\(^{125}\)Dukeminier, supra note 123, at 250 (“The causal relationship principle has been misunderstood by some writers, who have criticized it as vague and uncertain and have gone on to misapply it in ways that boggle the mind.”).

Negligence cases frequently present this type of question when one person’s acts or failures to act caused some specific harm to some other person. Similar phrases appear throughout statutory and judicial law; phrases such as “owing to,” “due to,” “result,” “attributable to,” “the consequence of,” and “caused by.” Prosser phrased the same principle in a more descriptive manner: “[w]henever that would have happened when and as it did happen, had it not been for this, this is an actual cause of that.”

Despite the similarity of these phrases, it is important to carefully construct causal questions so as to avoid inviting the reply that the so-called cause was merely a contributing factor. For example, it is clearly preferable to posit “Did the death result from an injury?” than “Did the injury cause the death?” It is often necessary to show that a particular act or omission was the cause not just a cause. Thus, “proximity in space or time is the . . . chief criterion which differentiates the causal connection which is legally significant from that which is not.” It is from this concept that the expression “proximate cause” arose. Legal scholars have expressed a great deal of consternation about this term:

[I]t is undoubtedly the general opinion that the field of legal liability is greatly cluttered by ‘proximate causation’ and that it needs to be cleaned up . . . . The courts have built up a wilderness of precedents

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128 PROSSER, supra, note 126.


130 HART AND HONORE’, supra note 127.
which is impenetrable to any great depths by any field notes indicated in
their opinions . . . . Their calls and courses cannot be followed, their
steps cannot be retraced, their corners and monuments relocated.131

Nonetheless, this expression reminds us that it is not enough to show the effect
was a necessary condition of the cause, but like philosophical models of causation,
there must be temporal precedence. For example, in insurance cases, the insured must
show the covered peril was the factual cause of the loss. In personal injury cases,
death more than a year after the injury, rules out proximity because of the possibility of
some intervening causal factors.132

In many tort cases, however, the existence of liability is only part of the
picture. The extent of liability also depends in many instances upon establishing a
causal connection. The question of the amount of damage caused by one person’s act
or omission may also present causal questions:

In other types of cases it is necessary to show causal connection
between action and harm in order to determine the extent of liability;
and in others still it will be necessary, in order to determine both the
existence and the extent of liability. In contract, for example, it may
often suffice to establish the existence of liability simply to show that
the defendant failed to deliver goods on the stipulated day, and this
usually raises no causal problem determining, in such cases, how much
loss the defendant’s failure to deliver has caused to the plaintiff.133

131 GREEN, LEON, RATIONALE OF PROXIMATE CAUSE, (Rothman Reprints, 1976),
Preface.

132 HART AND HONORE’, supra note 127.

133 Id. at 85.
Other causal questions may arise in determining whether some undue benefit derived from an act or omission rather than a loss. For instance, in Payne v. Railway Executive an injury occurred to an individual due to another's negligence forcing them to retire from the Navy. The defendant tried to have the damages reduced by the amount of the disability pension being received by the plaintiff. The Court found, however, that the pension was not a consequence of the negligent act but of the plaintiff's Naval service and therefore, had no effect upon damages.\textsuperscript{134}

Some scholars would argue that "[m]odern cases have substituted the test of responsibility or fault for that of causation."\textsuperscript{135} What this implies is that legal issues often involve more than simple factual questions of proximate cause, but often deal also with questions of policy. In those areas, especially dealing with the extent of liability, policy matters often control or mediate the outcome. For instance, it has long been the law in New York that if a fire is started through negligence, even when the fire spreads to numerous buildings, liability is limited to the extent of the first such building.\textsuperscript{136} Restricting liability in this manner allows business to operate without the threat of gigantic awards against them. Negligently starting a fire is not considered a "sufficiently grave moral offense to warrant the transfer of the whole of vast losses from where they fall to the shoulders of the negligent."\textsuperscript{137} This example clearly identifies the two elements of legal questions; causal or factual ones, and questions of policy:

\begin{thebibliography}{99}
\bibitem{134} (1952) 1 KB 26.
\bibitem{135} Goodhart, A.L., Notes of an Address on Special Problems of the Law of Torts, 71 LAW QUARTERLY REVIEW 402, 413 (1955).
\bibitem{136} Ryan v. New York Central Railway Co., (1866) 35 NY 210, 91 Am.
\bibitem{137} HART AND HONORE', supra note 127, at 89.
\end{thebibliography}
The only factual element in the question whether a defendant's act is for legal purposes the cause of harm is whether or not the harm would have happened without the act. There are many names for this factual component including, 'cause in fact', 'material case', 'conditio sine qua non', and is the sole point of contact with what causation means apart from the law. All the remaining components are questions of the law's policy, to be found in the court's conception of what limitation's are just and expedient or in accord with the rationale or 'purpose' of legal rules . . . The only factual part of causal questions is whether or not the alleged cause was a sine qua non of what has occurred.\textsuperscript{138}

These two elements have long been a part of the law as evidenced by the following quote from a 1928 case: "[w]hat we do mean by the word 'proximate' is that because of convenience, of public policy, of a rough sense of justice, the law arbitrarily declines to trace a series of events beyond a certain point. This is not logic. It is practical politics."\textsuperscript{139}

Legal questions are not simply questions of causation, but of causation and responsibility; of causation and public policy. This is one reason that philosophical and social science models are difficult, if not impossible to adapt to legal definitions. They deal only with issues of fact or probability and provide no opportunity for judgement or public policy.

In addition, the emphases on questions of proximate causation in tort law make these legal models difficult to apply to other legal issues. In cases involving exclusivity or unrelated income issues, no conditio sine qua non or cause in fact may exist as in

\textsuperscript{138}Id. at 90.

\textsuperscript{139}Palsgraf v. Long Island R.R. Co., (1928) 248 NY 339.
the law of torts or, if there is, a myriad of other extraneous data and information may obscure it. The traditional doctrines of tort law deal in large part with more black and white issues. Often, a simple three part question arises which directs the inquiry: “the three questions are whether the defendant was under a duty of care, whether he was in a legal sense guilty of negligence to the plaintiff, and whether his action was the proximate cause of the plaintiff’s injury are really one and the same.”

Or more simply stated, “is the consequence worth the risk...” There is no similar recipe for questions of exclusivity and thus, its adaptability to the issue at hand is questionable. Further, legal scholars have long questioned the traditional doctrines of tort law, dismissing proximate cause as an outdated and ineffective maxim. Much of the criticism of this traditional doctrine centers around the belief that these formulas or recipes have never really performed at the level for which they were designed and they are incomplete and thus, ineffectual:

[I]f cases are examined in which a perplexed judge made valiant efforts to apply these rules, it is impossible not to sympathize with the wish to cut loose from the tradition which gave such rules birth. Their main effect was to render obscure the language of the court’s decision without affording it any guidance. . . . [G]eneral rules for determining proximate cause very often contained explicit or implicit references to principles of legal policy; their appearance of defining proximate cause in factual, policy neutral terms was little more than a sham, since they only asserted, in effect, that to be the proximate cause of harm something must be ‘in law’ its cause. The vicious circle in such formulations was not usually as short as this, but it was vicious nonetheless. Rules were formulated in terms of factors which were


'substantial' or 'efficient', and factors negating causal connection were described as 'intervening forces', but to each of these quoted expressions the words 'in law' had to be added; and this threw the problem back on to the tribunals which the rules were intended to guide.\(^{142}\) (emphasis added).

Legal rules or recipes are illusory at best, and at worst, unintelligible. One commentator pointed out that it is impossible to make "word schemes" do what professional judgement only can do: "rules will carry [judges] into the neighborhood of a problem and then [they] must get off and walk . . . . [G]eneral policies can never take the place of judgement."\(^{143}\) There is substantial agreement from other scholars: "It neither is nor should be possible to extract rules which cover the subject of legal cause and are definite enough to solve cases."\(^{144}\) And from still others: "It follows that it is in error to speak of the cause of anything."\(^{145}\)

Finally, as was indicated above in the discussion of other models, "there is no sole cause of anything . . . any particular event has a host of causes . . . an investigation of the causes of an event then, is incomplete."\(^{146}\) The legal profession has been caught up in the language of causation for a long time and while it may seem ineffectual, it's easy to understand why, it's the best there is available:

\(^{142}\)HART AND HONORE', supra note 127, at 96-97.

\(^{143}\)GREEN, LEON, JUDGE AND JURY, in HART AND HONORE', supra note 127, at 98.

\(^{144}\)Edgerton, J., Legal Cause, 72 U. PENNSYL. L.R. 211 (1924).

\(^{145}\)BECHT AND MILLER, supra note 126, at 12.

\(^{146}\)Id.
It is easy to be misled by the natural metaphor of a causal 'chain', which may lead us to think that the causal process consists of a series of single events each of which is dependent upon (would not have occurred without) its predecessor in the 'chain' and so is dependent upon the initiating action or event. In truth, in any causal process we have at each phase, not single events but complex sets of conditions and among these conditions are some which are not only subsequent to, but independent of the initiating action or event.147

Leon Green has suggested that its best to describe questions of fact by terms such as “material,” “appreciable” or “substantial” and that these terms, though factual, “cannot be further differentiated.”148 Similarly, social scientists admit that while much of social science research is couched in terms of causation, “causal thinking belongs completely on the theoretical level and . . . causal laws can never be demonstrated empirically.”149 This brings us full circle to the issue of substantiality in the exclusivity test.

Other Comments. “Knowledge of what is likely to happen if something is deliberately varied has great practical value for social policy. Without causal knowledge one cannot easily bring about desired changes or eliminate undesirable states.”150 Although the courts and the IRS have loosely interpreted the substantiality

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147 HART AND HONORE’, supra note 127, at 72.

148 GREEN, in HART AND HONORE’, supra note 143, at 214.

149 BLALOCK, HUBERT M., JR., CAUSAL INFERENCE IN NON-EXPERIMENTAL RESEARCH, 172 -73 (1964). See also COOK, THOMAS D. AND CAMPBELL, DONALD T., QUASI-EXPERIMENTATION: DESIGN & ANALYSIS ISSUES FOR FIELD SETTINGS, 33 (1979) (“[W]e are reconciled to the fact that in the social sciences the causal explanations we will be dealing with will be molar and contingently causal rather than ultimately . . . inevitable.”).

150 COOK AND CAMPBELL, supra note 149.
test, it appears to be a reasonably acceptable legal model by which to give the courts sufficient knowledge and flexibility to enforce public policy. Although couched in the language of causation, it appears to be consistent with current legal theory. That is, the courts must evaluate individual facts and circumstances in making decisions about the nature, scope and motivation of each activity and the presence and extent of the required causal connections.

The full Oversight Subcommittee of the House Ways and Means Committee reviewed a written summary of their recommendations to revise the unrelated income statutes in June, 1988.\textsuperscript{151} In final form, the subcommittee backed away abruptly from any fundamental change to the substantially related test. Continued meetings and discussions to date have produced no alternative tests. Perhaps due to some of the reasons enumerated above, it is unlikely a more objective standard will ever be identified.

The Concept of Nondistribution Constraint

\textbf{Introduction.} The IRS in reviewing organizations' continuing qualification for exemption places primary importance on whether an organization engages in activities with "public purposes rather than private interests."\textsuperscript{152} Although quoted in Chapter 1, it seems important to repeat the definition of charity embodied in Section 501(c)(3) of the 1986 Internal Revenue Code:

\textsuperscript{151}Jones, P., \textit{Ways and Means Oversight Sub-Committee Members Given List of UBIT Proposals}, 37 \textit{TAX NOTES} 1498, 1499 (1988).

[C]orporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition . . . or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual . . . . (emphasis added).

At issue is whether or not some portion of the operational test of the statute, more specifically, the absolute prohibition against private inurement, continues to be an important constraint upon nonprofit organizations' activities.\(^{153}\)

There is a significant amount of legal precedent for denial of exempt status on the basis of the private inurement prohibition. Many of the cases deal with the founders of religious movements or organizations including Church of Scientology of California v. Commissioner\(^{154}\); Peterson v. Commissioner\(^{155}\); Bubbling Well Church of Love v. Commissioner\(^{156}\); Church of the Transfiguring Spirit\(^{157}\); and many, many others. Even a seemingly insignificant amount of private inurement may result in revocation of exempt status (e.g. see Human Engineering Institute\(^{158}\) and McGahen v.

\(^{153}\)Hansmann was the first to describe the private inurement prohibition as “nondistribution constraint” in The Role of Nonprofit Enterprise, supra note 45, however, the terms are used interchangeably throughout this analysis.

\(^{154}\)823 F.2d 1310 (9th Cir. 1987), aff’g 83 TC 381 (1984).

\(^{155}\)TCM 1987-108 (2-24-87).

\(^{156}\)670 F.2d 104 (9th Cir. 1981), aff’g 74 TC 531 (1980).

\(^{157}\)76 TC 1 (1981).

\(^{158}\)TCM 1978-145, aff’d 629 F.2d 1160 (CA-6, 1980).
Commissioner,\textsuperscript{159} however, there is precedent to the contrary, allowing continued exemption despite "incidental" private inurement (e.g. see Revenue Ruling 66-358,\textsuperscript{160} Revenue Ruling 77-367\textsuperscript{161}). There are legal precedents involving religious organizations, as well as numerous educational and other organizations. These include Birmingham Business College v. Commissioner\textsuperscript{162}, Texas Trade School\textsuperscript{163}, and John Marshall Law School v. U.S.\textsuperscript{164}. In addition to case law, there have been numerous published and private IRS rulings, Technical Advice Memorandums (TAMs), and General Counsel Memorandums (GCMs) dealing with private benefit constraints. Courts generally do not permit citation of many of these rulings in litigation, but they provide significant insight into the Service's position relative to these issues.

The primary issues in any determination of private inurement include: a) whether any private benefit is inconsistent with the accomplishment of an organization's exempt purpose; and b) the definition of private individual or shareholder. The latter will be discussed first.

\textbf{Private Individual or Shareholder Defined.} The Income Tax Regulations stipulate that organizations do not operate exclusively for exempt purposes if net

\begin{itemize}
\item \textsuperscript{159}76 TC 468, 482 (1981), \textit{aff'd} 720 F.2d 664 (3rd Cir. 1983).
\item \textsuperscript{160}1966-2 CB 218.
\item \textsuperscript{161}1977-2 CB 193.
\item \textsuperscript{162}276 F.2d 476, 480 (5th Cir., 1960).
\item \textsuperscript{163}30 TC 642 (1958), \textit{aff'd} 272 F.2d 168 (CA-5, 1959).
\item \textsuperscript{164}81-2 USTC 9514 (Ct. Cl. 1981).
\end{itemize}
earnings inure in whole or in part to the benefit of private shareholders or individuals as defined in Regulation Section 1.501(a)-1(c).\textsuperscript{165} That regulation defines private shareholder or individual as any person having a personal and private interest in the activities of the organization. Further, Regulation Section 1.501(c)(3)-1(d)(1)(ii) requires that an exempt organization serve public rather than private interests by demonstrating that it is at all times organized and operated in such a way so as to avoid personally benefiting private interests such as “designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.”

Traditionally, the class of persons “having a personal and private interest in the activities of the organization” included only those who could directly or indirectly influence the decisions of the organization to their own benefit such as the founders, officers, directors, major contributors, or family members of any of these (e.g. see Horace Heidt Foundation\textsuperscript{166}, Revenue Ruling 76-91\textsuperscript{167}; and Texas Trade School\textsuperscript{168}). The case law for the most part supports this definition (e.g. Founding Church of Scientology v. U.S.\textsuperscript{169} and Sound Health Association v. Commissioner\textsuperscript{170} wherein the U.S. Tax Court noted that the concept of private benefit “is limited to the situation in which an organization’s insiders . . . are benefited” (emphasis added)).

\textsuperscript{165} Treas.Reg. Section 1.501(c)(3)-1(c)(2).

\textsuperscript{166} 170 F. Supp. 634 (Ct. Cl., 1959).

\textsuperscript{167} 1976-1 CB 149.

\textsuperscript{168} 30 TC 642 (1958), aff’d per curiam 59-2 USTC 9786 (CA-5 1959).


\textsuperscript{170} 71 TC 158, 185-187 (1978).
However, the Service has sought for some time to expand the definition of private individual or shareholder well beyond the traditional view it only included insiders. In a number of GCMs, counsel for the Treasury concluded that any individual receiving a prohibited benefit, regardless of their ability to influence the organization, or the payment or amount of the benefit, is a "private individual or shareholder" for the purpose of the private benefit prohibition. For instance, in GCM 39498 (April 24, 1986) counsel noted that even employees or other individuals having a "close professional working relationship" with the organization, without any other connection, have a personal and private rather than a public interest in the activities of the organization. Further, in GCM 38905 (June 11, 1982) even an outside independent investment consultant was subject to the inurement proscription. GCM 39670 (October 14, 1987) reiterated this position: "[i]t is our opinion that all persons performing services for an organization have a personal and private interest and therefore possess the requisite relationship necessary to find private benefit or inurement."

It is interesting to note that, despite the Service’s strong stance, in each instance the persons in question were in a position to control or influence the payment or amount of the prohibited benefit. It is unfortunate the statute and its legislative history do not provide a more succinct definition of the phrase private inurement. Nonetheless, it appears the Service intends to aggressively pursue its own interpretation, as evidenced by the GCMs above as well as in GCM 38283 (February 15, 1980), 37180 (June 24, 1977), 35869 (June 21, 1974) and 35865 (June 21, 1974) even though that interpretation remains in large part untested in the courts.
Any review of whether net earnings inured to any private individual must include an understanding of what net earnings are. Unfortunately, this term is undefined by the statute and regulations for this purpose. Therefore, one must look to the courts for a workable definition. The traditional, technical accounting definition is simply the gross earnings less expenses equals net earnings. However, this traditional or literal meaning is not favored for the purpose of making exemption determinations. For instance, in *Virginia Mason Hospital Association v. Larson*,\(^ {171}\) the court found that “net earnings . . . should not be given a strictly literal construction, as in the accountant’s sense.” Similarly in *Northwestern Municipal Association v. U.S.*,\(^ {172}\) and other cases the courts have redefined net earnings to mean generally any payment to any individual that is not in furtherance of an exempt charitable purpose regardless of its source.

This view . . . represents the current application of the term ‘net earnings’—today, a more generalized ‘private benefit’ test. The reference in the statute to ‘net earnings’ was largely obliterated by the U.S. Tax Court when it held that ‘paying over a portion of gross earnings to those vested with the control of a charitable organization constitutes private inurement as well’, adding that ‘all in all, taking a slice off the top should be no less prohibited than a slice out of net’.\(^ {173}\)

**Private Benefit Defined.—Types of Private Inurement.** Somewhat more difficult to deal with is the issue of whether any payment is consistent with an organization’s exempt purpose. There are many different types or forms which

\(^{171}\) 114 P.2d 978, 983 (Sup. Ct. Wash. 1941).

\(^{172}\) 99 F.2d 460 (8th Cir. 1938).

inurement can assume any one of which should cost an organization its exemption. Whether the payments constitute reasonable compensation presents just one type. Other types of inurement discussed below include payment of dividends or other equity distribution; rental arrangements; use of charity’s assets without fair compensation; loans of charity assets; payment of personal expenses including furnishing refreshments, goods or services; assumption of liabilities; excessive perquisites; sham transactions; and partnerships or joint ventures with for-profits.

Questions of reasonable compensation are factual determinations dependent upon the circumstances and details of each individual situation (e.g. Jones Bros. Bakery v. U.S.). The payment of reasonable compensation is consistent with a charitable purpose and does not constitute private inurement (see Ruud Int’l v. U.S.). A very large salary or wage in absolute dollar amount, while not dispositive in and of itself as unreasonable, generally constitutes a prohibited benefit particularly if the employee had opportunity to influence the timing or amount of the compensation (e.g. B.H.W. Anesthesia Foundation, Inc. v. Commissioner). There are numerous cases where the employer calculated the employee’s compensation by reference to some formula of net earnings or gross receipts. Arrangements such as these, especially when they set no upper limit as the amount of total compensation, have been successfully attacked by the Service time and time again (e.g. People of God

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174 411 F.2d 1282 (Ct. Cl. 1969).
176 72 TC 681 (1979).
Community v. Commissioner\(^{177}\); Church by Mail, Inc.\(^{178}\) and Founding Church of Scientology\(^{179}\).

The Service has further taken the position that proof of reasonable compensation does not bar a finding of private inurement. Review of a number of GCMs provides evidence of the Service’s position. For instance, in GCM 38322 (March 24, 1980) counsel found that it was the manner in which compensation was determined that violated the nondistribution constraint even though the actual amount of compensation paid was reasonable. The Service contends that private benefit exists whenever the method for computing compensation presents the possibility of inhibiting the ability of the organization to achieve its exempt purpose. Providing adequate safeguards however, precludes the finding of a private benefit (e.g. GCM 38905 (October 6, 1982)).\(^{180}\)

The primary safeguards were first outlined by Chief Counsel in GCM 32453 (November 30, 1962) and include: a) requiring that the service provider maintain an arm’s length relationship with the organization; b) the service provider not participate in the management or control of the organization; c) the compensation arrangement should serve a real and discernible business purpose; d) the amount of compensation

\(^{177}\) 75 TC 127, 132 (1980).

\(^{178}\) 48 TCM 471 (1984), aff’d 85-2 USTC 9549 (CA-9, 1985).


\(^{180}\) See also Yanowitz, Alan J. and Purcell, Elizabeth A., Contingent Compensation Arrangements that Lack Safeguards May Jeopardize Exemption, JOURNAL OF TAXATION, April 1983, at 208-212.
should not be dependent upon revenue realized as a result of the relationship; c) an upper limit as to the amount of compensation is established; and f) in actuality there is no evidence of abuse or prohibited benefit.

In GCM 39670 (October 14, 1987) Chief Counsel suggested the following issues should be reviewed to determine avoidance of private benefit:

1) whether that compensation package is . . . merely a device to distribute profits to principals or transform the organization's principal activity into a joint venture;

2) whether the package is as a result of arm's length bargaining; and

3) whether the compensation constitutes reasonable compensation.

If it is determined that the compensation package as a whole meets these tests, the mere form that it takes will not per se result in prohibited inurement or private benefit.

There is also precedent allowing contingent compensation arrangements based upon sales, gross revenue or some other similar formula if it is normal industry practice (as in fundraising) and reasonable in amount (see National Foundation, Inc.181). Charities should consider the following additional safeguards to provide supplementary evidence as to the arm's length nature of their agreements, their reasonableness, and their actual results as being ordinary and necessary and absent any abuse:

1811987-2 USTC 9602 (Ct.Cl. 1987).
• Requiring periodic reports of activities in support of Foundation goals;

• Setting more specific performance standards in the contracts which can be compared with actual performance;

• For deferred compensation accounts, limit the amount of earnings those funds would be entitled to in order to prevent a windfall;

• Have the individuals acknowledge the arrangements as being part of their total compensation and incentive related in part to all their duties;

• Conform deferred compensation arrangements to all requirements of Section 457 if they do not already;

• Research to the extent of available information the salary and other compensation levels of other persons in similar positions at similar organizations\(^{182}\) and;

• Conform compensation agreements to confirm the charitable intent of the charity and attempt to dollarize the charitable and compensation-for-services elements.

\(^{182}\text{See e.g., LANGER, STEVEN, COMPENSATION IN NONPROFIT ORGANIZATIONS, (6th ed., Abbott, Langer & Assoc. eds., 1993).}\)
• Provide for repayment (including interest thereon) should any amount later be determined to be unreasonable.

Inurement violations involve more than issues of reasonable compensation, this is just the most common type of inurement decision. In *Cranley v. Commissioner*, the Tax Court ruled that the Cranley Research Foundation did not qualify for tax exempt status because of the private inurement prohibition. The facts indicated that the Foundation employed a nurse and also worked for Dr. Cranley in his private practice without additional compensation to either the nurse or the Foundation. Similarly, in *Horace Heidt Foundation v. U.S.*, an organization to provide musical instruction, living quarters and medical assistance to young people who appeared on Mr. Heidt’s radio program and other shows, was denied exemption because the recipients of the organization’s charitable services were in the employ of Mr. Heidt and therefore, he personally benefited. These cases are illustrative of the nondistribution constraint at work on other than reasonable compensation issues. Other types of inurement that can result in a finding of a violation of the nondistribution constraint include:

• Retained interests such as rights of possession;  

• Rental arrangements at other than arm’s length terms;

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183 31 TC 1217 (1959).


• Loans to insiders;¹⁸⁷

• Provision of goods or refreshments to members;¹⁸⁸

• Rendering of services to insiders;¹⁸⁹

• Assumption of liabilities of related persons;¹⁹⁰

• Purchase of property from insiders at an amount in excess of fair market value including payments for "goodwill";¹⁹¹

• Joint ventures with commercial entities;¹⁹²

¹⁸⁶ Founding Church of Scientology v. U.S., supra note 179; Texas Trade School v. Commissioner, supra note 168.


¹⁹¹ Hancock Academy of Savannah, Inc. v. Commissioner, supra note 190.

¹⁹² Plumstead Theatre Society, Inc. v. Commissioner, 74 TC 1324 (1980). See also Priv. Ltr. Rul. 7921018; and, Yanowitz, Alan J., and Purcell, Elizabeth A., Using the
Tax avoidance schemes;\textsuperscript{193}

The private inurement proscription (nondistribution constraint) hopefully prevents these various types of ethical breaches from becoming the norm. Similar prohibitions exist for noncharitable exempt organizations specifically those described in Sections 501(c)(6), (c)(7), (c)(9), (c)(11), (c)(13) and (c)(19). However, the absence of such a prohibition in other Code Sections does not permit inurement by these other organizations. "(If one thinks of inurement as stealing, then presumably such a requirement is implicit in each Code Section, notwithstanding its absence."\textsuperscript{194}

Private inurement is not the same as engaging in commercial for-profit activities in a charitable organization. The Code permits commercial activities even if substantial as long as they are not the primary activities and purposes of the organization, and tolerates only incidental amounts of inurement.\textsuperscript{195}


\textsuperscript{193}IRM, \textit{supra} note 152, at 7751, 343.4 ("Transactions of this type are lacking in substance in the sense that the transferor is still, in effect, engaging in his business or profession in his individual capacity. Since the organization is operated by the transferor essentially as an attempt to reduce his personal federal income tax liability while still enjoying the benefits of his earnings, the organization’s primary function is to serve the private interest of its creator rather than a public interest."). \textit{See also} Walker v. Commissioner, 37 TCM 1851 (1978); Boyer v. Commissioner, 69 TC 521 (1977); Freedom Church of Revelation, 84-1 USTC 9485 (DDC 1984); The Church of Eternal Life and Liberty, Inc. v. Commissioner, 86 TC No. 54 (1986).


\textsuperscript{195}See Tesdahl, D. Benson, \textit{IRS Bends Private Inurement and Self-Dealing Rules}, \textit{PHILANTHROPY MONTHLY}, June, 1994, at 33-34 (reported on IRS Notice 94-87,
The private inurement doctrine embodies the unique difference between nonprofit and forprofit organizations. That is, for the most part, the characteristics of both categories of organization are identical: both require a legal form, pay compensation, face essentially the same expenses, are able to receive a profit and make investments, and produce goods and services. But, unlike the forprofit entity, the nonprofit organization cannot distribute its profits (net earnings) to those who control it and/or financially support it, that is, there may not be any authentic equity ownership in a nonprofit organization. Thus, the private inurement doctrine—elsewhere termed the 'nondistribution constraint'—is the substantive dividing line between the nonprofits and forprofits and has been heralded as one of the chief reasons a service is provided or a product is produced by a nonprofit rather than a forprofit organization.\(^{196}\) (footnotes omitted)

The Literature of Crisis

Introduction

While unethical behavior in the nonprofit sector is empirically less felonious than it is in the other two sectors, it is—in its own way—no less pervasive. In this sector, because we expect more good, we accept less bad; and the standards which we employ are much more sensitive to deviation.\(^{197}\)

released August 22, 1994 implying the Service took it upon themselves to bend or waive the statutory prohibition in the interest of disaster relief, despite the fact there is no “emergency exception anywhere in the private inurement or self-dealing rules.”).

\(^{196}\)Hopkins, supra note 14, at 240.

\(^{197}\)Rubin, Hank, Dimensions of Institutional Ethics: A Framework for Interpreting the Ethical Context of the Nonprofit Sector, in Gies, Ott and Shafritz, supra note 23 at 211.
It is disheartening to find in the press all too frequently lately, the story of the failed, wasteful, ineffective, or rich and greedy nonprofit organization or of the self serving, greedy or downright dishonest nonprofit manager. Stories have appeared not just in the nonprofit press either, but in *The Wall Street Journal*, *The Philadelphia Inquirer*, *The Norwich (Connecticut) Bulletin*, *The Denver Post*, and *The Montgomery (Alabama) Advertiser*. The problems are appearing in many geographical areas, with many different types of charities involved (e.g. there are cases involving hospitals, universities, religious organizations, scientific organizations, arts and literary organizations, etc.), or to any particular size organization. Even respected organizations like the Girl Scouts and Toys for Tots have been under fire.

If these reports are true, the problem is widespread and growing. There is however, no empirical evidence of either. Instead, a few highly inflammatory

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204 Kimelman, John, *Too Charitable to Charities? - Why Congress Should Get Tough on America's $400 Billion Charity Industry*, FINANCIAL WORLD MAGAZINE,
anecdotes have been highly publicized, pointing out what appears to be a crisis in public confidence.

A recent poll indicated that citizen confidence in the voluntary sector has dropped substantially since 1990.205 The study conducted in early 1994 by the Daniel Yankelovich Group for the National Civic League indicated as much as 17 percent of the population had lost confidence in the ability of nonprofits and religious organizations. “[T]he 17 percent losses experienced by nonprofits and religious organizations were striking . . . their loss of public confidence suggests citizens increasingly distrust all organized institutions as well as the people associated with them.”206

Similarly, in a Harris poll it was reported that in the 1960s approximately 61 percent of Americans placed a high degree of confidence in the people running higher education, while today, only 25 percent think the same thing.207 The source of this distrust is unclear. Surely the problem organization existed before the press reported their abuses. It is not clear whether the abuses and excesses of the 1970’s and 1980’s are just now catching up to the culprits or whether the reporting of these incidents has affected the public’s perceptions of the sector as a whole. Empirical research, in fact,

September, 1994, at 1, (“Many lawmakers are beginning to question whether they have coddled these institutions for too long.”).


206Id.

207Id. See also, ROCHE, GEORGE, THE FALL OF THE IVORY TOWER (1994).
indicates that charitable organizations have not changed substantially in purpose, character or sources of income over the last twenty years.\(^{208}\)

An Historical Perspective

The issue of charity abuses seems to come up every few years since nonprofits were first franchised into the tax law in 1913. As early as the Walsh Commission in 1916, charities, specifically private foundations, were looked upon with great suspicion as playthings for the rich who wished to control the provision of “social services” in the U.S.\(^{209}\) “Private foundations are ... chastised for being elitist, playthings of the wealthy, and havens of ‘do-gooders’ assuaging their inner needs by dispensing beneficence to others.”\(^{210}\)

The Revenue Acts of 1918, 1921, 1934, 1936, 1938 all added provisions affecting charitable organizations, often with little or no explanation.\(^{211}\) About this time, other areas of the law also began to focus upon the nonprofit organization. For

\(^{208}\)Bowen, Nygren, Turner and Duffy, The Charitable Nonprofits, An Analysis of Institutional Dynamics and Characteristics, 190 (1994) (“Contrary to our expectations and to what others have suggested, we did not find evidence of any persistent tendency for earned income to increase, relative to other funding sources . . . . Revenue profiles appear to be much more stable over time than we had expected them to be . . . . This . . . attribute characterized institutions in all sectors, including both faster-growing and slower-growing institutions.”).


\(^{210}\)Hopkins, \textit{supra} note 14, at 429.

\(^{211}\)Scrivner, \textit{in} Gies, Ott and Shafritz, \textit{supra} note 23, at 127.
instance, the Nonprofit Institutions Act passed in 1938 as an amendment to the Robinson-Patman Act dealing with price discrimination.\textsuperscript{212} Although this Act did not deal with exemption issues it provides further evidence of the interest Congress began to direct at nonprofit organizations and their activities.

Then in 1943 the attacks began in earnest. It was at this time that Congress began to segment Section 501(c)(3) organizations between publicly supported ones and nonpublicly supported or private organizations. The sources of support and the types of activities organizations engaged in became increasingly important to the determination of exempt status. Private entities were those that received the majority of their support from one individual, one family or any other small group of individuals or corporations and were treated much less favorably by subsequent legislation.\textsuperscript{213}

Again in 1950 and 1954, Congress took action to separate the public and private organizations and added statutes designed to tax unrelated activities found to be in competition with for profit business. This was just the beginning of intense interest in the activities of nonprofit organizations. A number of studies conducted throughout the late 1950s and 1960s evaluated the impact of nonprofit organizations on the economy; their commercial activities; their dealings with related parties; and their funding and expenditures.\textsuperscript{214} From 1964 to 1967 the IRS audited some 47,754

\begin{footnotesize}
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\item[212] 15 U.S.C. Section 13c.
\item[213] See e.g., Revenue Act of 1943, ch. 63, Section 117, 58 Stat. 21, 36-37 (1944) and Revenue Act of 1950, ch. 994, Section 331, 64 Stat. 906, 957-58 (these statutes first prohibited private foundations from engaging in transactions with related parties at less than arm's-length).
\item[214] See e.g., TAX-EXEMPT FOUNDATIONS AND CHARITABLE TRUSTS: THEIR IMPACT ON THE ECONOMY, 87th Cong., 2nd Sess. (1962); FINAL REPORT OF THE SELECT
\end{enumerate}
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returns of exempt organizations and "screened or reviewed" some 500,000 others.215
"[F]ew matters of federal income taxation have been the subject of such extensive
discussion in the last two decades as the treatment of charities and other exempt
organizations and the closely related problems of deductions for charitable
contributions."216

Congress held 14 hearings on the activities of nonprofits between 1950 and
1969. In addition, numerous statistical studies and economic analyses were conducted
to assess the impact of the exemption and charitable deduction provisions. There was
widespread belief "there may be much that is wrong" with the nonprofit sector.217

The likelihood that alleged [charity] abuses would eventually
result in statutory modification was on the increase. A Treasury
Department report on private foundations, issued in 1965, emphasized
the view that there was a need for more public involvement in the
operation of philanthropic institutions that benefit from preferential
treatment under the tax laws.218

committee to investigate foundations and other organizations, H.R. Rep.
no. 2514, 82nd Cong. 2nd Sess. (1952) also called the cox commission report
(investigating communist and other subversive influences); foundations, private
giving and public policy, report and recommendations of the commission
on foundations and private philanthropy, also called the peterson
commission report, staff of the senate comm. on finance and house ways

215 Stone, supra note 18.

216 Id.

217 Stone, supra note 18, at 34. See also, Hartke, Sen. Vance, foundations at the
crossroads, 121 congressional record 3035 (1975).

218 Hopkins, supra note 14, at 436.
All these hearings and investigations culminated in the 1969 Tax Reform Act, the most far reaching piece of legislation affecting nonprofit organizations ever enacted. Much of the Act was designed to eliminate, punish or prevent perceived legal and ethical abuses, particularly at private charitable foundations.219 "The language of the Act, its legislative history, the graduated levels of the sanctions imposed, and almost confiscatory level of the exactions assessed, convince us that the exactions in question were intended to curb the described conduct through pecuniary punishment."220

Improving enforcement of nonprofit provisions by the IRS was another goal. For instance, the Committee Reports of the Joint Committee who worked on the 1969 Act indicate that enforcement of “arm’s length standards” relative to transactions between organizations and their contributors, founders, directors or others required “disproportionately great[er] enforcement efforts.” Therefore, the Act added specific provisions aimed at prohibiting “self dealing” by providing detailed prohibitions and more easily enforced sanctions.221

Although the 1969 Act significantly changed the definition of charity, it really did little to dispel the perception of abuse. New studies and commissions began anew to review the impact and activities of charities including the Filer Commission in 1973. In their report to Congress in 1975 entitled Giving in America: Toward a Stronger

219 See IRC Section 4941-4947.

220 In re Unified Control Systems, Inc., 586 F.2d 1036 (5th Cir. 1978).

Voluntary Sector many of the provisions of the 1969 Reform Act however, were criticized. And the Commission provided recommendations for corrections.\textsuperscript{222} Subsequently relaxation of certain provisions occurred, but the basic strict regulatory framework remains, as do concerns about the sector: "[c]ontinuing concerns linger on Capitol Hill about (foundations) . . . and whether or not stricter limits . . . should be enacted."\textsuperscript{223}

Tax Acts in 1976, 1978, 1980, 1981, 1982, 1984 and 1986 all contained provisions affecting nonprofits, with both favorable and unfavorable impacts. For instance, in 1984 Congress changed some of the excise tax provisions affecting private foundations, particularly those dealing with excess business holdings and the excise tax on investment income. Thus, the perception of the existence of legal and ethical problems in the nonprofit sector is a lingering one.

The Nature of Current Criticism

Much of what has been reported recently, just as in past studies, commissions and committee reports, did not show any abuse at all, but implied, merely due to the size of the holdings of certain organizations, that those holdings in and of themselves constitute an abuse or present the potential for abuse.\textsuperscript{224} For example, Gaul and Borowski singled out Memorial Sloan-Kettering Cancer Center in New York because

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\item \textsuperscript{222} Edie, John, Congress and Foundations: Historical Summary, \textit{in}, \textit{AMERICA'S WEALTHY AND THE FUTURE OF FOUNDATIONS}, 60 (Odendahl, Teresa, ed., 1987).
\item \textsuperscript{223} \textit{Id.} at 64.
\item \textsuperscript{224} Gaul and Borowski, \textit{supra} note 199.
\end{itemize}
it had $250 million in reserves and is the beneficiary of a $92 million trust fund yet continues to solicit charitable gifts.\textsuperscript{225} Similarly, these authors criticized the Archdiocese of Philadelphia for owning some $225 million in land in and around Philadelphia which is, of course, exempt from property tax.\textsuperscript{226} Harvard too, was recently portrayed as greedy when they announced a $2.1 billion fundraising campaign, the largest such campaign ever.\textsuperscript{227} A recent book also criticized the well-respected trio of the American Cancer Society, the American Heart Association and the American Lung Association.\textsuperscript{228} The authors of this book contend that these organizations are hoarding resources rather than using gifts and contributions for their intended purposes.\textsuperscript{229} 

The *Philadelphia Inquirer* article previously mentioned was particularly adept at making such implications, especially when it implied individuals pay higher taxes because these “wealthy” organizations pay none. It appears a fair amount of inconsistencies, gaps and obfuscation were apparent in the *Inquirer* articles. James Joseph, President of the Council on Foundations, pointed out some of these gaps and misinformation in an article in the July/August 1993 issue of *Foundation News*:

\textsuperscript{225}Id.

\textsuperscript{226}Id.


\textsuperscript{229}Id. at 16.
I am especially concerned about articles and reports that confuse foundations with other tax-exempt organizations. Tax exemption is not synonymous with charity. In fact, 24 of the 25 categories of tax exempt organizations under U.S. law are not charitable groups at all. Their objectives and their behavior should not be confused with the many acts of compassion and the practices of philanthropy that deTocqueville described as the ‘habits of the heart’ of the American people. It is important that the public understand why the charitable deduction is one of the oldest in the tax code—and that it is not a special interest loophole, but an opportunity to use private resources for public good.230

The nonprofit literature has also publicized several instances of possible legal and ethical breaches the most visible of which was the William Aramony scandal at the United Way.231 Accused of excessive compensation, elaborate and expensive perquisites, fat retirement and questionable travel and entertainment reimbursements, Mr. Aramony resigned in shame.232 Mr. Aramony was subsequently indicted, convicted, and sentenced to 7 years in prison.233 Apparently, the public’s expectations


233Tannenbaum, Jeffrey A., Three Former United Way Aides are Indicted on Fraud Charges, WALL ST. J., Wednesday, Sept. 14, 1994, at B7 (also indicted were Stephen Paulachak, formerly President of Partnership Umbrella, a related entity, and Thomas J. Merlo, formerly chief financial officer for United Way). See also, Associated Press, Ex-Charity Chief Gets 7 Years in Embezzlement, ARIZONA DAILY STAR, June 23, 1995, at A5.
for someone in his position may have been significantly different from the reality. These expectations are what makes charities such easy targets for implications of wrongdoing.

Another example of a possible breach receiving attention in the press was a recent transaction of the Christian Broadcasting Network (CBN):

In the CBN transaction, television evangelist Pat Robertson converted a $150,000 investment into stock worth $90 million . . . through a spin-off of the Family Channel, created by CBN in 1977 . . . . As the Channel became more successful, CBN sought to protect its exempt status by divesting itself of the Family Channel. The channel sold for $250 million, and Robertson’s $150,000 investment soared in value. . . . [T]he spin-off was a management-led debt financed buy-out.

State regulation of charitable solicitations has also received a fair amount of press. Much of the debate about charitable solicitations is in the context of a

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234 Tannenbaum, supra note 233, at B7 (“It is important that the public have confidence both in charities and the tax system . . . . The government will prosecute those who abuse the system by diverting funds from tax exempt charities for their private use and willfully fail to report that income on their tax returns.”).

235 Carson, Marlis, Sanders Provides Overview of Partnerships and Joint Ventures Involving Tax-Exempt Organizations, 9 EXEMPT ORGANIZATION TAX REVIEW 1203, 1204 (June, 1994).

constitutional argument about free speech which greatly complicates the issue. The Supreme Court has thus, entered the debate of these important First Amendment issues.\textsuperscript{237} This issue even extends beyond national boundaries. In Canada a recent court case dealt with many of the constitutional issues faced here in the U.S. The Court of Appeals in Alberta held in \textit{Epilepsy Canada} that it is appropriate to protect fundraising against unnecessary government intervention.\textsuperscript{238}

Also at issue in much of the current discussion about regulation at both the federal and state level, is the cost of fundraising and administration, specifically, whether a very large relative cost is evidence \textit{per se} of private benefit, or mismanagement (see for instance the \textit{United Cancer Council} case).\textsuperscript{239} Numerous stories implicating long standing charities have appeared with little or no evidence to support these contentions. For instance, the Christian Children’s Fund, a Virginia based organization that provides money and other assistance to children worldwide recently found itself chastised in the press because one former board member accused the organization of financial mismanagement, yet no proof was presented to support

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\end{footnotesize}
the accusation. In a recent IRS Technical Advice Memorandum surprisingly the Service found no private benefit resulted from an organization hiring its creator to be its primary outside fundraiser. These are issues similar to the United Cancer Council case except the fundraiser in that situation was an unrelated party, yet, the organization forfeited its exemption because some 90 percent of the organization’s income went to pay the outside fundraiser.

The public accountability of foundations and other charitable organizations is lacking despite the fact that most (except for many smaller organizations and religious organizations) file detailed Federal tax forms annually which are open to public inspection (for-profit corporations’ tax returns are not subject to public inspection). Recently the Financial Accounting Standards Board, the standard setting arm of the accounting profession, issued new accounting pronouncements significantly changing the financial statement disclosures required of nonprofit organizations in an attempt to make reporting more uniform among the variety of charitable nonprofits and more understandable. These changes have been largely resisted by many members of the charitable community. As a practical matter, these rules will only affect the largest of charities, those who have annual independent audits and prepare financial statements in accordance with generally accepted accounting principles. Only some 8.7 percent of

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2419417003. See also Tesdahl, Ben, IRS Allows an “Insider” to be a Paid Fundraiser, PHILANTHROPY MONTHLY, April 1994, at 37.


the nation’s private charitable foundations publish any sort of annual report to the public however, recently there is an increase in awareness of the public’s desire for information and accountability.244 “We invite people to suspect us. If we refuse to tell people what we do, we cannot expect to have friends in time of need. If we refuse to respond to inquiries, we shall make enemies rather than friends.”245

The National Policy Debate

Introduction

Current conditions indicate that the potential for conflict will not abate, and probably will intensify. The economic importance of the nonprofit sector has grown at a significantly increased rate. Nonprofits are increasingly undertaking new activities and adopting new methods of operation which warrant a reexamination of their societal role and the attributes of nonprofit status . . . . The wide range of government-bestowed privileges for nonprofits, pressures on lawmakers and regulators . . . and the decentralized system of agencies . . . employed to regulate specific aspects of the relationship between nonprofits and government . . . ensure fertile ground for controversy and conflict . . . . The increased pressures on nonprofits resulting from decreased government funding may suggest the need for closer monitoring of nonprofits to ensure that nonprofits are legitimately pursuing the public good in a manner that inspires public confidence . . . .246

244 McIlney, Dennis P., The Public Accountability of Foundations: Private Organizations in the Public Interest, PHILANTHROPY MATTERS, 16-17 (Indiana University Center on Philanthropy, Spring, 1993).


246 FACHINA, BAZIL, SHOWELL, EVAN, AND STONE, JAN E., PRIVILEGES AND EXEMPTIONS ENJOYED BY NONPROFIT ORGANIZATIONS: A CATALOG AND SOME
It is apparent, the perception of legal and ethical crisis has arisen periodically, but appears lately to have increased or intensified. The reasons for this renewed and intense interest include:

- The steep increase in indirect government support to charities and other exempt organizations may have led to increasing concerns about the size, form and necessity of so large a subsidy, particularly when reports of record federal budget deficits flood our collective consciousness;

- As part of the federal budget process, the necessity to analyze and dollarize the costs and benefits of various or alternative government programs affecting nonprofits may have focused attention on these organizations unnecessarily;

- Higher than average tax rates over the last 40 years have led many to call for elimination of perceived abuses, improved administration and enforcement, and greater tax equity;

- Concern over unfair competition of nonprofits engaged in forprofit businesses has led to broader examination and questioning of nonprofit activities; and

THOUGHTS ON POLICYMAKING, (N.Y.U. School of Law, 1993) (hereinafter FACHINA, SHOWELL AND STONE).
• Because more than 50 percent of tax deductible contributions are to religious organizations, increased anxiety about government subsidies through exemptions and deductions exist, as well as concern about church/state separation.\textsuperscript{247}

The current crisis also stems in large part from two competing views, both of which are important to the preservation of democratic values. Protecting the right of the public to know and their interest in the use of private philanthropy is certainly as important as, but often in conflict with, the rights of free association and privacy for the private charitable corporations. Where an issue of settled public policy is at stake however, the courts have often weighed the public's interest more heavily than the private.\textsuperscript{248}

There are three main arguments in favor of privacy and free association for nonprofits:\textsuperscript{249}

• The funding for many charities, particularly many smaller religious organizations and private charitable foundations, comes in large part from a small group of private citizens using private money. Therefore, what they

\textsuperscript{247}Stone, \textit{supra} note 18, at 32.


\textsuperscript{249}McIlnay, \textit{supra} note 244, at 13.
Some argue a sort of philanthropic marketplace or force is at work, not unlike the economic forces affecting the forprofit sector, which checks abuses. Replacing these unseen forces with government intervention and regulation is seen as an attempt to socialize private philanthropy;

• The freedom of choice and free association now afforded philanthropic organizations to support any cause or belief, even unpopular ones, would be in jeopardy or lost entirely if too much government intervention ensues.\(^{250}\)

Most scholars and researchers agree that “nonprofits lack the guidance the market provides corporations.”\(^{251}\) Thus, the second contention above is a mere smoke screen. In addition, there is no evidence to support the third contention above. The first of these arguments is the only one with any validity, yet even that argument has its limits. The government simply cannot support through exemption, causes that conflict

\(^{250}\) *Id.*

\(^{251}\) Herzlinger, *supra* note 203, at 52 (further: “The reactions of clients to the products and services that nonprofits offer are not as revealing as the responses of customers to the products and services sold by a forprofit company. Because nonprofits are usually subsidized and their services are frequently free, clients are more likely to forgive poor quality and ignore inefficiency.”).
with settled public policy matters such as permitting exemption for organizations that promote violence or racial discrimination without anarchy ensuing.252

As previously discussed, there is no one professional organization or association which can oversee and set standards for the nonprofit sector; no one government agency assigned the task of regulation and oversight for nonprofits; and there are no invisible market forces. The sector’s lack of attention to public accountability has led to more suspicion and further calls for regulation. Many charities fear government regulation yet little or no action toward self regulation, the necessary ingredient to avoiding such regulation, has taken place:

Only two years after the United Way of America scandal and one year after The Philadelphia Inquirer’s shocking expose of abuses at some of the nation’s biggest charitable organizations, the nonprofit world seems to be back to business as usual . . . . In short nonprofit organizations may have weathered the storm without altering any of their practices . . . . Self regulation has become the front-line policy for dealing with the problems facing nonprofit organizations. That explains why so little has happened. Little evidence exists to prove that self-regulation has ever worked very well.253

Where Do We Go From Here?

Everyone seems to have an opinion as to what is best for the nonprofit sector. Unfortunately, those opinions are too often unsupported by facts or at most, only

252 See e.g., Big Mama Rag v. U.S., supra; or National Alliance, supra.

253 Eisenberg, Pablo, Charities’ Response to Criticism: Business as Usual, 9 EXEMPT ORGANIZATION TAX REVIEW 1214 (June 1994).
partially informed by incomplete facts. Even the House Ways and Means Committee Subcommittee investigation of nonprofit practices relies in large part upon anecdotal information. One example cited by the Subcommittee was of a taxable insurance company holding itself out as a nonprofit association “formed to mobilize members for charitable work.”254 Perhaps such a representation requires a governmental response, but this is not an instance of abuse by an exempt charitable organization. Despite the lack of empirical data about charities’ abuses the perception remains that: “there are real abuses out there, we are not talking about micromanaging salary levels of close cases—we’re talking about stopping the looting . . . . There has been a shift from not if Congress will enact intermediate sanctions, but when and how.”255

Intermediate sanctions is the term used by the Committee and the Treasury Department for limits, penalties and additional disclosure requirements now being considered in Congress. These proposals include a two tiered tax on inurement such as unreasonable compensation or non-fair market value transactions “where an insider pays too little or the organization pays too much”; questions about continued exemption for certain commercial nonprofits such as HMOs, hospitals and other health care organizations; taxation of some membership dues for noncharitable exempt organizations such as trade or agricultural organizations; and additional action to tax

254 Misleading Claims of Tax Exempt Status, 9 EXEMPT ORGANIZATION TAX REVIEW 1231 (June 1994).

255 Carson, Marlis and Streckfus, Paul, EO Lawyers Get an Earful From the Government, 9 EXEMPT ORGANIZATION TAX REVIEW 1231 (June 1994) (quoting Kathleen Niles, tax counsel to the House Ways and Means Committee).
commercial activities such as insurance arrangements, advertising and affinity programs.\textsuperscript{256}

Self regulation is still the cry from many nonprofits,\textsuperscript{257} while others suggest new studies or commissions\textsuperscript{258}; some would recommend a "modified regulatory system" with only one agency responsible for regulating nonprofits regardless of the nature of the activity\textsuperscript{259}; or additional federal, state or local regulation.\textsuperscript{260} Regardless of the scheme selected what is needed are facts; facts about what organizations are doing; what types of illegal and unethical acts are being pursued by the government as against the public interest; and to what success. This analysis of the case law affecting nonprofits may provide many of those facts as well as provide clues as to how best to respond whether through new policy decisions, enforcement mechanisms or practice or ethical standards.


\textsuperscript{257} Joseph, \textit{supra} note 230, at 38. \textit{See also} McIlney, \textit{supra} note 243, at 15.

\textsuperscript{258} Eisenberg, \textit{supra} note 253, at 1215. \textit{See also} Stone, \textit{supra} note 18.

\textsuperscript{259} FACINA, SHOWELL, AND STONE, \textit{supra} note 246, at 112-113.

\textsuperscript{260} HOPKINS, \textit{supra} note 14, at 875.
CHAPTER 3

METHODOLOGY

General Methodology

Introduction

The general purpose of this study is to determine if there exist common characteristics in federal tax cases affecting charitable organizations which can provide clues to possible responses to the legal and ethical crisis currently perceived to exist. From the case law, it may be possible to develop an understanding of the types and frequency of illegal acts by charities and what effect those acts had upon continued qualification of these organizations for exemption. The elements of the study include an identification and categorization of the types of illegal behavior apparent in tax litigation involving charitable organizations; identification of the patterns, if any, of illegal behavior by charities; determination of whether these problems appear in both public and private charities; identification of what issues appear to be most important to the government to pursue in litigation and to what success; and evaluation of cases for evidence of other factors to be pursued.

The major legal criteria imposed on charities and identified by a review of the theories and literature of exemption above, are the nondistribution constraint and
exclusivity requirement presently enumerated in the tax law.¹ The literature dealing with the current crisis broadens these criteria to include issues beyond the scope of this analysis such as other criminal or other illegal acts. Thus, the public’s criteria are generally more stringent and perhaps less objective even than the current statute which, offers substantial room for interpretation. Applying the current statutory criteria along with the more general public benefit and the “not in conflict with settled public policy” criteria added by the courts, it may be possible to sift the present statutory requirements through the tax litigation to evaluate its sufficiency in dealing with these problems.² This information will allow us to draw some conclusions about the character of the law as compared with practice in the charitable sector and may suggest possible responses for dealing with undesirable or ineffective elements of the statute or suggest new enforcement mechanisms or professional standards.

Assumptions

The major (or “macro-”) assumption to this study is that the case law involving charities is a representative microcosm of illegal and unethical behavior in nonprofit

¹Slocumbe, Walter B., Charities and Federal Taxes: Issues for Analysis, in Conference Proceedings, RESEARCH AGENDA: LEGAL ISSUES AFFECTING NONPROFIT ORGANIZATIONS, 3 (N.Y.U. School of Law, November 10-11, 1989) (hereinafter RESEARCH AGENDA: LEGAL ISSUES) (“Legally critical to the tax benefit of charity has been irrevocably foregoing the potential personal rewards of ownership of property held by the charity.”).

organization management and governance. This is a very reasonable assumption. While certainly, many cases involve instances of obvious abuse by those who seek to pervert the law to their own ends, it is not, as one might expect, only the most perverse organizations that take a matter to trial. Many cases involve sincere, well-meaning and well-managed organizations that feel strongly about what they perceive as arbitrary and overzealous enforcement of vague and intrusive regulations. Thus, both fraudulent and legitimate organizations, as well as both small and large organizations, will litigate. In addition, because the entire universe of exemption cases over the last 40 years since the adoption of the modern exemption statute is being examined, one would expect variations, abnormalities or anomalies in understanding, application and enforcement to disappear over time.

There are a number of sub-issues or process variables that may affect reliance upon the macro-assumption, such that one must assume: a) the audit selection process at the Service is unbiased and operates with a certain degree of consistency and detachment; b) the quality of the prosecutors of these cases and their preparation is not significantly different case to case; c) similarly, the quality of the defense counsel and their preparation is fairly consistent; d) the judges asked to adjudicate these issues, regardless of venue, are relatively free of personal or professional bias; e) there are no important mistakes of law in most cases; and f) there are no other intervening factors.

This analysis involves looking for discrete illegal acts and the resultant judicial decision to strip the organization of its exemption. The cases document the illegal acts while these other variables, these process variables, are not and thus, are not subject to measurement as to effect, even though they might mediate the outcome.
Assumptions are necessary to any research project. If any sense is to be made of the world, at some point those factors which cannot be controlled must simply be accepted and the inquiry must proceed. “No matter how elaborate the design, certain simplifying assumptions must always be made. In particular, we must at some point assume that the effects of confounding factors are negligible.”

Typology

One of the stated goals of the study is to develop a typology of illegal acts by charities. When looking for violations of the statutory or public policy criteria in each case, it is essential to know what one is looking for. Included below are the accepted definitions of each known type of statutory violation, variation from the public benefit requirement or action against settled public policy. This constitutes the typology of illegal acts that will be referred to throughout the text. The survey of the case law itself may reveal new types of violations not included herein. These new or other types of violations might include failures of the organizational test of the statute, failures to take other action to secure exemption or, other violations. This will be discussed further in Chapter 4. Included in the typology below are only those definitions which can be gleaned from the Tax Code itself, the Income Tax Regulations, Temporary or Proposed Regulations, the Internal Revenue Manual, long-standing published (not private) Revenue Rulings, GCMs, TAMs, or other currently undisputed Revenue


pronouncements, settled case law (e.g., Bob Jones University) and various other sources. The source is indicated for each type of illegal act.

Very often law is discovered rather than made. That is, the statutory requirements are often very broad which then requires the courts to apply the broad statements to particular circumstances to define the reach of the law. Thus, many of the individual definitions stem from the case law. The numbering of the types of violations below is important as each type may be referred to by its number later on in the analysis.

Types of Private Inurement.

1) Unreasonable Compensation—Compensation and/or benefits will be considered unreasonable if paid to any person without first being the subject of arm’s-length negotiation between the organization and the person receiving payment; where the service provider participated to some extent in management or decision making for the organization; the compensation arrangement served no real or discernible business purpose; or, the way in which the compensation was calculated presented the opportunity for manipulation and/or a windfall. Unreasonable compensation constitutes private inurement.5

2) Non-arm’s Length Transaction—Any completed transaction, contract agreement or arrangement is not arm’s-length if any person possessed the opportunity for undue influence over the terms, and where such influence could have resulted in a

5Adapted from G.C.M. 32453 (November 30, 1962).
private benefit, regardless of whether or not that person exercised such influence. Such transactions could result in revocation of exemption.\(^6\)

3) Retained Interests in Property or Income—Deferred or retained interests in the organization’s income or assets, such as reversionary interests, certain partial interests in property, or leasehold interests requiring improvements, present the opportunity for use of the organization’s resources in such a way as to constitute a form of indirect private inurement.\(^7\)

4) Loans to Insiders—Incidental to the operations of the organization, funds are advanced to a creator, officer, director, trustee or other related party on other than arm’s-length terms; or, advances are made to friends or acquaintances of insiders at less than commercial rates and/or without adequate security or business purpose.\(^8\)

5) Rendering of Services to Insiders—Services provided to members, members’ families, creators, officers, directors or trustees or other related parties which are personal in nature such as parking, transportation, meals, recreation, use of property owned by the entity for personal purposes, without reimbursement at fair

\(^6\) Adapted from Hancock Academy of Savannah, Inc. v. Commissioner, 69 TC 488 (1977).


\(^8\) IRM, 7751, 382.2(3); Griswold v. Comm., 39 TC 620 (1962); and Rev. Rul. 67-5, 67-1 CB 123.
value or the provision of other services with no real or discernible business purpose constitutes private inurement.\textsuperscript{9}

\textbf{6) Assumption of Liabilities of Related Parties}—Any agreement whereby the organization agrees to accept property subject to debt or to assume or pay the debt or obligation of any person related to or in a position to control or influence the decisions of the organization constitutes private inurement.\textsuperscript{10}

\textbf{7) Payment of Personal Expenses}—Payment or reimbursement made to any related party of any expense which is personal in nature such as utilities or other living expenses, nonbusiness meals, commuting, entertainment, or any other expense of a personal nature not treated as part of compensation would be considered private inurement.\textsuperscript{11}

\textbf{8) Investments Benefiting Insiders}—Where an organization acquires any investment the primary purpose of which is to benefit private interests or, fails to take appropriate action to protect any investment ultimately benefiting related private interests, exemption may be lost even though the investment ultimately proves profitable.\textsuperscript{12}

\textsuperscript{9}IRM, 7751, 382.43, 382.44 and Rev. Rul. 69-175, 69-1 CB 149.

\textsuperscript{10}Hancock Academy of Savannah, Inc. v. Comm., 69 TC 488 (1977).

\textsuperscript{11}Texas Trade School v. Commissioner, 30 TC 642, aff'd d. 272 F.2d 168 (CA-5, 1959); Rev. Rul. 69-256, 69-1 CB 150; and Rev. Rul 67-367, 67-2 CB 188.

\textsuperscript{12}IRM, 7751, 382.2(1); and Leon A. Beeghly Fund v. Commissioner, 35 TC 490, 518 (1960).
9) **Equity Distributions**—The payment of dividends or other direct or indirect distribution of the income or assets of a charitable organization results in the organization failing to qualify as charitable.\(^\text{13}\)

**Types of Exclusivity Violations.**

1) **Tax Avoidance Schemes**—Transactions, transfers, agreements or arrangements between any person and a charitable organization wholly lacking in substance in the sense that the individual is still in effect engaging in his/her business or profession in his/her individual capacity and the transfer was undertaken essentially as an attempt to reduce personal income tax liability while still enjoying the benefits of his/her earnings. Thus, the organization’s primary function is to serve the private interests of its creator rather than a public interest.\(^\text{14}\)

2) **Partnerships or Joint Ventures**—Commercial enterprises undertaken jointly with for-profit partners, companies or investors, the primary purpose of which is not to serve a charitable goal but income or profit; and which make no provision for prohibition of acts inconsistent with the organization’s exempt purpose; no provision is made to limit profits to prevent a windfall for the for-profit investors; the charity provides guarantees or there is no restriction as to capital calls on charity funds; the charity’s contribution is substantial and at risk; debt financing is full recourse

\(^{13}\)Maynard Hospital, Inc. v. Commissioner, 52 TC 1006 (1969).

\(^{14}\)IRM, 7751, 382.3; Rev. Rul. 76-442, 76-2 CB 148; and Boyer v. Commissioner, 69 TC 521 (1977).
presenting the possibility of calls against charity assets; or, despite the form, the substance of the transaction indicates a strong profit orientation, then the organization fails the exclusivity requirement.\textsuperscript{15}

3) **Qualified Exempt Purpose Not Practiced**—Scholarships, grants or gifts to friends and relatives of persons in control of the organization or any other substantial activity lacking in purpose, intent or operation to serve charitable purposes are indicative of a noncharitable purpose.\textsuperscript{16}

4) **Excess Lobbying or Political Activity**—A substantial part of the organization’s activities involve attempts to influence legislation by propaganda or otherwise, including urging the public to contact members of a legislative body to support, propose or oppose any legislation; advocating the adoption or rejection of legislation; or, \textit{even if insubstantial}, participating or intervening directly or indirectly in any political campaign on behalf of or in opposition to any candidate.\textsuperscript{17}

5) **Size and Extent of Commercial or Unrelated Activities**—The size of any commercial activity and the manner in which it is conducted (e.g. an activity conducted in a very businesslike manner over a substantial part of the year) are beyond

\textsuperscript{15}G.C.M. 39005; G.C.M. 36293; Plumstead Theatre Society, Inc. v. Commissioner, 74 TC 1324 (1980), \textit{aff’d per curiam} USTC 9358 (CA-9 1982).


\textsuperscript{17}Treas. Reg. Section 1.501(c)(3)-1(c)(3)(ii); Section 501(c)(3); Treas. Reg. Section 1.501(c)(3)-1(b)(3)(ii); and Treas. Reg. Section 1.501(c)(3)-1(e)(iii).
the reasonable needs of the organization for its charitable purpose such that the commercial activity and the realization of profit thereon become a primary purpose. 18

**Types of Public Benefit or Public Policy Violations.**

1) **Insufficient Public Benefit**—An organization whose primary purpose is to retain gain or profit; who conducts no substantial charitable programs; who makes public benefit secondary or incidental to building income or corpus; or who creates benefits in support of particular business interests, even if such interests are unrelated to the organization’s creators, directors, officers, trustees or contributors, is not a charitable organization. 19

2) **Actions Against Settled Public Policy**—Any act or failure to act, any organizational policy, decision, activity, program or purpose in conflict with any settled public policy (e.g. racial discrimination in admissions; sex discrimination; tax evasion; or drug trafficking) is indicative of a noncharitable purpose and not entitled to exemption. 20

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18 Treas. Reg. Section 1.501(c)(3)-1(e)(1).

19 United Cancer Council, Inc. v. Commissioner, 100 TC No. 11, 93 TNT 57-19 (1993); Treas. Reg. Section 1.501(c)(3)-1(d)(5)(iv)(b); and IRM, 7715, 383.2.

The case review may identify other types of violations that could give new, different or more particular insights into various aspects of nonprofit management and governance. From previously unenumerated violations definitions can be constructed and the typology can be expanded. As mentioned briefly above, cases involving these other violations might include litigation over the failure of the organizational test of the statute, failure to take other action necessary to secure exemption, or other violations. More about that later. The violation typology is summarized in the following Figure 3.1.

**FIGURE 3.1**
Typology of Violations

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<th>a</th>
<th>b</th>
<th>c</th>
<th>d</th>
<th>e</th>
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<tbody>
<tr>
<td>1</td>
<td>Private Inurement</td>
<td>Unreasonable compensation</td>
<td>Non arm's length transactions</td>
<td>Retained interests</td>
<td>Loans to insiders</td>
</tr>
<tr>
<td>2</td>
<td>Exclusivity Violations</td>
<td>Tax avoidance schemes</td>
<td>Partnerships or joint ventures</td>
<td>Exempt purpose not practiced</td>
<td>Lobbying or political activity</td>
</tr>
<tr>
<td>3</td>
<td>Public Policy Violations</td>
<td>Insufficient public benefit</td>
<td>Actions against public policy</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Failures to Act</td>
<td>Organizationa l test</td>
<td>Other failures to act</td>
<td>Other violations</td>
<td></td>
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</tbody>
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135
1. Private Assumption of Payment of Investment Equity
   Inurement liabilities personal benefiting distributions

2. Exclusivity Violations

3. Public Policy Violations

4. Failures to Act

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<th>f</th>
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<th>i</th>
</tr>
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<tbody>
<tr>
<td>Assumption of liabilities</td>
<td>Payment of personal expenses</td>
<td>Investment benefiting insiders</td>
<td>Equity distributions</td>
</tr>
</tbody>
</table>

Form of Research

The study will be primarily a descriptive survey combined with some case study. The survey of the universe of exemption cases over the last 40 years can provide large amounts of data for analysis as to their possible relationships. This is a typical type of research study when large amounts of statistics or official reports are available in the public domain. It will be possible to take the case law and classify it a number of different ways such as by type, frequency or central tendency. This type of study can reveal patterns or previously undiscovered details about the process. Adding case study to this type of undertaking can then help to explain the extremes in the data and provide important information that the survey cannot. For instance, case law in which the decision was not the expected decision despite the violation of some statutory or public policy criteria may yield important information for charities' managers about how to avoid illegal or unethical acts that jeopardize their organizations' exemption.

The research will be both analytical and historical in approach. Analysis of only fully adjudicated cases satisfies the historical aspect. It may be possible to identify historical landmarks in the case law from which some conclusions about the nature of litigation involving charities might be drawn.\textsuperscript{22} The analytical aspect, described further below, requires analysis of case law for where each case fits within the typology of illegal acts and for clues, if any, as to how best to respond to these acts. The analytical form is one often used in studies which review some form of litigation for classes of data to guide the development of principles and actions.\textsuperscript{23}

Case law may be the best or if not, at least one of the best ways to evaluate the state of charities management and governance. Case law takes settled facts and sifts them through the statutory law to establish a fit. When that fit is bad in exemption cases, instances of legal and ethical violations should be apparent.

It is important to distinguish between making ethical judgments and studying those judgments.\textsuperscript{24} This study will not involve any classification of case law or classes of charitable organizations as “good” or “bad” ones. It will rather, involve the study of value judgments made by those organizations and the people who run them and

\textsuperscript{22}e.g. Bob Jones University, supra note 20 (this decision set the stage for the introduction of broader public policy matters such as racism into determinations of exempt status).

\textsuperscript{23}See e.g., MAUCH, JAMES AND BIRCH, JACK, GUIDE TO THE SUCCESSFUL THESIS AND DISSERTATION, 70 (1983) (wherein “state court interpretations of permissive legislation on nonschool use of school property . . .” was cited as an example of the analytical form).

\textsuperscript{24}GOODE, WILLIAM J. AND HATT, PAUL K., METHODS IN SOCIAL RESEARCH, 68 (1962).
how those value judgments ultimately affected their continued qualification for exemption. Neither will the judiciary’s judgments be classified in value-laden terms. The sole criteria for evaluating the decisions will be the statutory and public policy criteria previously discussed. The application of some other criteria in a case will necessitate a detailed analysis of the individual case to determine what other criteria the court felt was important. If there are other criteria, they may have important ramifications for nonprofit management and governance.

Specific Procedures

Introduction

Described below in chronological order are the steps necessary to analyze the case law for the types of illegal acts. The section following the specific procedures includes a detailed description of the research population previously mentioned in Chapter 1.

Steps

Classifying Case Law. In order to get one’s arms around this large body of case law, it is first advisable to attempt to categorize the case law into four classes. The following matrix can help in the categorization process.
Identifying the four classes with letters A through D allows us to easily identify the cases in each class when included in large tables or figures where limited space inhibits more descriptive phraseology. The first step then is to identify which cases fit into each class of the matrix. Cases where illegal acts are present and loss of exemption resulted would belong in class A. This will most likely be the largest number of cases as the presence of these acts under present law should almost always result in loss of exemption. This should be the case unless the judiciary decided to relax the statutory requirement or there has been some technicality such as a mistake as to procedure or in the application of law which, regardless of the factual determination, resulted in the organization’s exemption being left intact. Cases of this
class would belong in class D. Cases where exemption was retained despite the presence of illegal acts (class D) should be fewer in number than those where illegal acts were present and exemption was forfeited (class A) as the presence of these violations generally should not go unpunished. Remember, the presence of even *de minimis* amounts of inurement under present law should result in forfeiture of exemption.

When violations of the statutory exemption or public policy criteria are absent from an exemption case, exemption should be retained unless, there are some other undiscovered factors. The number of these cases, if any, would appear in class B where exemption was forfeited despite the lack of illegal acts and in class C where illegal acts were absent and exemption was retained.

Each case in the alphabetical list of cases would be assigned a consecutive number for ease of identification purposes then examined in turn to determine its classification and a mark placed in the matrix in the appropriate quadrant for that class. The total number of marks in each class can then be tallied. By using an alphabetical listing of all the cases and indicating which class each case falls in next to the case, each case will be easily identifiable as to class allowing for more detailed study of certain classes of cases later on.

**Identifying Cases by Type.** The classification of cases by type requires that each case be examined for each type of alleged violation described in the typology above. Using an alphabetical listing of all the cases, permits each case to be examined in turn. If a particular violation is present an “X” is placed next to that case and under a heading for each type of statutory, public benefit, public policy violation or other
violation. This part of the analysis will involve determining the frequency of the various types of illegal behaviors. This can provide important information about which issues require the most immediate attention. In those cases where illegal acts are known to exist regardless of outcome (class A and D cases) important information about the distribution of persons engaged in illegal acts is waiting to be discovered. Figure 3.3 includes a typology of persons engaged in illegal acts which when located in the case law, can assist in identifying the types of acts these persons are engaged in and the trends. This too will be valuable in determining the hot spots and ultimately, possible responses.
FIGURE 3.3
Typology of Persons Engaged in Illegal Acts

<table>
<thead>
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<th>Persons</th>
<th>PRIVATE INUREMENT VIOLATION TYPES</th>
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<td>Totals</td>
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<td>INSIDERS</td>
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<tr>
<td>Employees</td>
<td></td>
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<tr>
<td>Family Members</td>
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<tr>
<td>Other related parties</td>
<td></td>
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<tr>
<td>OUTSIDERS</td>
<td></td>
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<tr>
<td>Consultants</td>
<td></td>
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<tr>
<td>Ind. contractors</td>
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<tr>
<td>Other investors</td>
<td></td>
</tr>
<tr>
<td>Other unrelated persons</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Persons</th>
<th>EXCLUSIVITY VIOLATION TYPES</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Totals</td>
</tr>
<tr>
<td>INSIDERS</td>
<td></td>
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<tr>
<td>Founders</td>
<td></td>
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<tr>
<td>Directors</td>
<td></td>
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<tr>
<td>Officers</td>
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<td>Employees</td>
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<td>Family Members</td>
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<td>Other related parties</td>
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<td>Ind. contractors</td>
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<td>Other investors</td>
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<tr>
<td>Other unrelated</td>
<td></td>
</tr>
</tbody>
</table>

Letters (a) through (i) and (a) through (e) denote specific subtypes of illegal acts (see Figure 3.1).
Developing an understanding of the problem areas and problem persons will help in the development of strategies for solving those problems. For instance, if founders involved in non-arm's-length transactions is a high incidence act then suggestions for legislative solutions, new enforcement mechanisms or practice standards aimed at just such a problem will reveal themselves. These might include suggestions for more detailed or specific prohibitions, reporting requirements or additional penalties for noncompliance.

It will be interesting to learn what other issues, if any, might exist that are resulting in loss of exemption and the relative importance of these issues as compared with the established criteria. This information should be evident from closer examination of cases where exemption was retained despite the presence (class B) or absence (class C) of illegal acts. It is difficult at this time to suggest what these other issues might be, or their relative magnitude or importance to the finding in any case.

**Evaluating Changes in Distributions of Type Over Time.** It may also be possible to obtain other useful information by looking at all cases over various periods of time. This can provide important information about the incidence of certain types of violations and whether or not there has been a proportionate increase in these types over the last few years. Beginning with 1954, the year in which the modern exemption statute was adopted, each case will be identified with a particular decade, specifically the decade in which the final decision was rendered. Thus, cases decided between 1954 and 1963 would constitute one study group, 1964 through 1973 the next, 1974 through 1983 the third, and 1984 to 1994 the last. Using 10 year periods for this time series type of analysis is necessary to provide sufficiently large blocks of data from which to make generalizations. In addition it provides generally 4 even periods of time
allowing for ease of comparison between periods. Had other start or stop dates been selected, uneven periods of time might have resulted in apples to oranges comparisons. Selecting smaller but even time periods might not have provided sufficiently large blocks of data from which to draw conclusions; might have flattened out any trends; and would result in more complex and ungainly analysis most likely without any substantive change in the results. It will still be possible to identify historical landmarks in the case law and evaluate the effect, if any, particular cases might have had on subsequent trends or decisions. More about that later.

This part of the study can provide important information about what issues the Service is placing emphasis on pursuing in litigation and to what success. An increase in the proportion of a particular type of case may indicate a shift in emphasis and indicate new or different strategies, policies, or laws are necessary to deal with the crisis in confidence and that it may at least in part be justified. It is possible that the issues of public policy violations may have become increasingly important over the last 10 to 20 years since many of these issues were not part of the statutory scheme when enacting the modern exemption statute in 1954. Therefore, one would expect that a larger proportion of the total cases would be Type 3 cases over the last 5 or 10 years than over the last 20 or 40 years. This type of violation presents more difficult policy and enforcement choices and may suggest different responses than Type 1 or 2 cases.

Public versus Private Charities. It may be possible to obtain other information about the how changes in statutory requirements or enforcement affects charities by determining what the relationship of cases involving public versus private charities has been over time and whether this proportion has changed. If it has changed, it will be necessary to look for clues in the judicial or legislative history which might explain that
phenomenon. For instance, one would expect a larger proportion of cases involving private charities following the 1969 Reform Act which added numerous provisions calling for new and substantial restrictions and penalties on the activities of private foundations. Trends should reveal themselves from looking at the frequency of exemption cases involving public charities and private charities over the same 40 year study period split into 4 ten year blocks. This data may allow for some conclusions to be drawn about the effectiveness of legislative or enforcement responses to perceived abuse.

**Summarization of Characteristics.** It will be necessary to summarize the characteristics common to cases involving charitable exemptions so that some generalizations can be developed. Patterns of behavior and other common characteristics will emerge from the analysis which will provide clues to how best to respond to the crisis in confidence. History is often a great teacher. For instance, it is possible the frequency of a particular act cost an organization its exemption rather than the act itself. Or, there may be a connection between loss of exemption and the magnitude of the act. It is difficult at this point to posit just what characteristics will emerge as most pervasive or important to continued qualification for exemption. It will be useful to identify characteristics common not only to each class of cases but, between classes as well and, of course, if any are common to all cases.

**Techniques**

**Introduction.** It should be possible to employ passive-observational techniques to case law being examined in the study. This approach is a “nonexperimental method” common to descriptive studies, such as this one, where information is
discovered about the types, frequencies or central tendencies of data regardless of the fact that there is no manipulation of the data by the researcher.\textsuperscript{25} Social scientists often use these techniques to establish correlations between observed acts and from there, to justify significant policy changes.\textsuperscript{26} Once the trends are discovered it is possible to discuss what policy initiatives, enforcement options or new professional standards might be effective in dealing with these violations as revealed by the observational data.

\textbf{Limitations.} Previously mentioned above was the possibility of process variables affecting the outcome. The legal process presents a daunting number of process variables which do not lend themselves in many cases to observation or, even if they do, it is most likely impossible those variables can be linked in any significant way to the outcome. For instance, the predisposition of certain judges to favor the government's position in tax cases if it exists, is not a documented aspect of any of the cases reviewed.

Only fully documented and adjudicated cases will be dealt with herein. Thus, although there are obviously instances of illegal acts currently being litigated in many courts, only those in which a final decision has been rendered will be reviewed for the type of historical data necessary to this study.

\textsuperscript{25}COOK, THOMAS D., AND CAMPBELL, DONALD T., QUASI-EXPERIMENTATION: DESIGN \& ANALYSIS ISSUES FOR FIELD SETTINGS, 295 (1979).

\textsuperscript{26}Id. at 339.
There exists the possibility of other unspecified variables affecting the conclusions. It is nearly impossible in social settings to rule out or specify all possible explanations for any given outcome. This, then is an obvious limitation to any study that undertakes to draw conclusions by comparing orderly, long-term patterns of complex data.

Research Population

Introduction

As previously described above, the research population includes the entire universe of exemption cases for this analysis. This means every case adjudicated on issues involving the qualification for exemption of an organization at the federal level over the last 40 years. The only qualifier will be that the case must involve exemption of a Section 501(c)(3) charitable organization or applicant. The law does not require exempt organizations described in one of the other 24 subsections under 501(c) or in some other exemption section (such as 401, 501(d), 501(m) or 527) to follow the same rules nor are they generally held to the same standards or level of scrutiny as charitable organizations. For instance, there is no explicit private inurement prohibition in Sections 501(c)(2), (4), (5), (10), (12) or others. Thus, including these other organizations in the analysis would result in apples to oranges comparisons. As it is, charitable organizations are a diverse group, but, they are at least subject to the same statutory and public policy criteria relative to their federal tax exempt status.

These cases are all available in the public domain; that is, they are readily available in published case reporting services subscribed to by most law libraries, many public libraries and in public access legal databases. To identify the population of cases dealing solely with Section 501(c)(3) organizations a listing of exemption cases between 1954 and 1994 was first obtained from Lexis, a computerized database subscribed to by the University of Arizona School of Law, using key word searches. The list of some 850 cases was then compared with exemption case lists in published loose-leaf tax services such as Commerce Clearing House’s (CCH) to verify completeness and to avoid duplication. This allowed for the elimination of a number of cases. Each case was then cross-referenced to the CCH Citator, a loose-leaf service that indicates the cases in which any particular tax case is cited or used as precedent in any other case. This search provided approximately 100 additional case names which for unexplained reasons the Lexis database search did not identify. Each case was then reviewed to determine whether the exemption issues were those of a Section 501(c)(3) or some other type of organization. This reduced the list to approximately 720 cases.

The individual case reference often indicates which venue the individual case was in. For instance, the letters “TC” refer to a Tax Court decision; “TCM” to a Tax Court Memorandum decision; “DC” to a District Court decision; “Cir.” to a Circuit Court decision; “Ct.Cl.” to the Court of Claims; and “U.S.” or “Sup. Ct.” to a Supreme Court decision. In addition, there are published case reporting services that are compendiums of cases from many jurisdictions. For instance, the reference “USTC” refers to a CCH compendium of United States Tax Cases; “F. Supp.” refers to the Federal Supplement of court cases; “F. 2d” refers to the Federal Supplement, Second Series and “AFTR” refers to Prentice Hall’s American Federal Tax Reports compilation of tax cases.
Other sources which may require review or citation include of course the Internal Revenue Code of 1986 cited as “Code Section” or simply “IRC Section” followed by the number of the section. Income Tax Regulations are cited as “TTR” or “Treas. Reg. Section” followed by the number of the regulation. Published Internal Revenue Rulings, Revenue Procedures, General Counsel Memorandums, Technical Advice Memorandums and Bulletins are compiled each year in a Cumulative Bulletin. An individual ruling is cited as “Rev. Rul.” followed by the number of the ruling; Revenue Procedures are similarly cited as “Rev. Proc.” followed by the number; Revenue Bulletins as “IRB”; General Counsel Memorandum as “GCM”; Technical Advice Memorandum as “TAM” and the Cumulative Bulletin is identified simply by the letters “CB.” The Service also issues Private Letter Rulings to answer a tax question for a particular organization or taxpayer, publishes those rulings in the Internal Revenue Bulletin and identifies them simply as “PLR” or “Priv. Ltr. Rul.” followed by the ruling number. Thus, any of the data compiled through a survey of the case law and validated through a study of the statute, regulations, rulings, procedures and the like, can be duplicated by anyone with the time and inclination.

Specifications

The study will involve all federal tax cases involving exemption issues regardless of venue since 1954. This will mean a survey of approximately 720 cases over the last 40 years. More detail will come out of the survey.

It is not significant that the number of cases in aggregate has increased significantly over the last 40 years (there were some 136 exemption cases involving charitable organizations decided over the 40 years between 1913 and 1953).
number of charitable organizations, estimated at around 100,000 in 1954 is now well in excess of 500,000.\textsuperscript{28} This probably accounts for the rise in the number of cases. In fact, the Service prosecutes proportionally fewer cases as a percentage of the total population of charitable organizations today than in 1954.\textsuperscript{29}

Some portion of this increase may be attributable to clarification of the applicable law or public policy. That is, as each decision reached and reported becomes precedent upon which subsequent courts and judges can rely in rendering their judgments. Thus, there may be a cumulative effect to the case law; one would presume the law becomes more settled over time. While this seems logical when looking at case law in general, it would be extremely difficult to illustrate as each new case stands alone and must stand on its own merits. It would be possible to evaluate cases for citation of prior cases. It is apparent from observation, however, that almost all tax cases rely at least to some degree on precedent and that there is no practical way to confirm this perceived cumulative effect. Thus, such an analysis would most likely be inconclusive. The presumption that law becomes more settled over time in fact, may even be incorrect. Public policy affects the application of law and it is constantly changing. For instance, when the modern exemption statute was adopted in

\textsuperscript{28}HODGKINSON, VIRGINIA, WEITZMAN, MURRAY S., TOPPE, CHRISTOPHER M., AND NOGA, STEPHEN M., NONPROFIT ALMANAC: DIMENSIONS OF THE INDEPENDENT SECTOR, 186-87 (1992) (hereinafter DIMENSIONS) (there were some 460,289 charitable organizations in 1989 and new organizations (net of closures) of approximately 20,000 entities are being added each year).

\textsuperscript{29}See, DIMENSIONS, \textit{supra} note 28, at 186 (there were 4 exemption cases adjudicated in 1954 when the total population of Section 501(c)(3) organizations stood at around 100,000 while, only 5 cases were finally adjudicated in 1990 when the total number stood at about 480,000).
1954, the public policy prohibiting exemption for racially discriminatory private schools did not exist.\textsuperscript{30}

Similarly, the morals and ethics of this country have changed significantly over the last 40 years. The "sexual revolution," the peace movement, Watergate, Irangate, Whitewater, "political correctness," abandonment of religious values and other cultural phenomenon have contributed to more lenient mores and values which affects every aspect of American life including law enforcement. Acceptable and permissible behavior today may have resulted in loss of exemption 20 years ago.

\textsuperscript{30}This issue was settled by the Supreme Court in 1983 in Bob Jones University, \textit{supra} note 20.
CHAPTER 4

FINDINGS

Introduction

This analysis will show that present statutory and other legal, professional and public policy criteria are insufficient to police the activities of charitable organizations. The prevention or punishment of illegal and unethical behaviors in fact may have been hampered by overly broad rules; rules subject to widely varying interpretation or judgment. The data collected and illustrated below, identifies several common behaviors and characteristics which are not representative of the public's interest or consistent with prevailing policy and which are indicative of ineffectual rules and criteria. To understand the findings and conclusions requires a clear understanding of the research population.

The Case List and Its Development

The case list constitutes the research population for this study. It is essential therefore, that an understanding of the research population and its derivation be provided. The use of computerized tax research databases is widely accepted by the practicing legal community. The most commonly used services are the Lexis tax service and Westlaw. As described earlier, the preliminary case list was from a search of the Lexis database conducted with the assistance of Craig Barker, a CPA with Ernst
& Young in Tucson. Although preliminary Lexis database searches revealed more than 720 cases involving exemption issues to be available, more detailed analysis was necessary to compile the final case list of 389 cases. The following steps helped to confirm that this list was as complete and accurate as possible. The attached Appendix A is the final case list.

Steps

Key Word Searches. In addition to the Lexis search, broad key word database searches on three additional published tax databases helped to confirm the accuracy of the initial list. This involved searching for the key words “tax exemption,” “tax exempt status,” “exempt status revoked,” “exempt organization,” “qualified exempt organization,” “charitable organization,” “charity status,” “application for exemption,” “Section 501(c)(3) organization” and “qualified charitable organization” in the Tax Notes Infotax computerized database, the Klienrock computerized Tax Library, and on Westlaw, a computerized database similar to Lexis. In order to obtain a more independent view and due in part to the relatively complex search commands, the Westlaw search was undertaken by a tax practitioner, Larry Rollin, Esq.

Searches citing related Code sections were also conducted in order to verify as broad of coverage as possible. For instance, cases citing Sections 7428, declaratory judgments; Section 642(c), trust taxation; Section 2055, estate tax charitable deductions; Section 170, charitable contribution deductions; and Section 501(a), exempt organizations, were also reviewed for applicability and inclusion when exemption was a major issue in the case.
What the Searches Produced and Other Steps. The Infotax searches of each of these key word phrases produced a maximum search count of 760 cases. The Klienrock searches produced a maximum of 422 citations and the Westlaw searches produced 233 cases. Each of these lists was then compared and contrasted. Duplications were then eliminated and cases were identified for further review to see if they fit the selection criteria. As described in Chapter 3, it is necessary to limit the study to cases involving only 501(c)(3) charitable organizations. Thus, numerous cases were eliminated from the initial search lists because they dealt with exemption for some other type of exempt organization (e.g. Loftus v. Commissioner,\(^1\) dealing with an exempt Section 401(a) employee benefit trust; Eden Hall Farm,\(^2\) a Section 501(c)(4) social welfare organization; Jockey Club v. U.S.,\(^3\) a Section 501(c)(6) business league; John D. Rockefeller Cemetery Corp. v. Commissioner,\(^4\) an exempt Section 501(c)(13) cemetery corporation; or Augusta Golf Ass'n., Inc.,\(^5\) an exempt Section 501(c)(7) social club).

Other cases were eliminated from the final case list because exemption was either not at issue in the case or it was only tangentially so with no conclusion about the continued qualification being expressed. Some of the cases in this category dealt with deduction of business expenses under Section 162 (e.g. Jones Bros. Bakery\(^6\));

\(^1\) 90 TC 845.
\(^2\) 75-1 USTC 9282 (DC-PA 1975).
\(^3\) 56-1 USTC 9243.
\(^5\) 71-2 USTC 9664.
\(^6\) 69-2 USTC 9474 (Ct.Cl. 1969).
deduction of charitable contributions under Section 170 (e.g. *Bilingual Montessori School of Paris,*\(^7\) or *Kuper v. Commissioner*\(^8\)); various excise tax sections (e.g. see *Long Beach Junior Chamber of Commerce,*\(^9\) or *Salvation Army*\(^10\)); or assessment or enforcement issues (e.g. see *Alpine Fellowship Church of Love and Enlightenment,*\(^11\) or *Dykema v. U.S.*\(^12\)).

Numerous cases were also eliminated even though they dealt with exempt Section 501(c)(3) charitable organizations, but the organizations’ exempt status was not at issue. Instead, there were questions about the public charity versus private foundation status of the organizations (e.g. see *American Guidance Fdtn.*,\(^13\) *Change All-Souls Housing Corp.*,\(^14\) or *CREATE, Inc.*\(^15\)); or the organization was fighting a determination regarding the existence of unrelated business taxable income (e.g. see *Disabled American Veterans,*\(^16\) *Hope School,*\(^17\) or *Mass. Medical Society v. U.S.*\(^18\)).

\(^7\) 75 TC 480 (1986).
\(^8\) 64-2 USTC 9541.
\(^9\) 63-1 USTC 15,476, 64-1 USTC 15,549.
\(^10\) 56-1 USTC 9365 (DC-NY 1956).
\(^11\) 87-1 USTC 9203.
\(^12\) 81-2 USTC 9814.
\(^13\) 80-1 USTC 9452 (DC 1980).
\(^14\) 82-1 USTC 9194 (Ct.Cl. 1982).
\(^15\) 81-1 USTC 9152.
\(^16\) 80-2 USTC 9568 (Ct.Cl. 1980).
\(^17\) 80-1 USTC 9134 (CA-7 1980).
At least one case involved the question of inclusion in income under Section 61 (\textit{Greeno v. Commissioner},\textsuperscript{19}); while others dealt with employment taxes under various sections (e.g. \textit{Goldsboro Christian Schools},\textsuperscript{20}); filing requirements (\textit{Lutheran Social Service of Minn.}\textsuperscript{21}); and estate tax charitable deduction, (\textit{Krohn v. Commissioner}\textsuperscript{22}). These cases were similarly eliminated from consideration.

\textbf{The Final List}

This review of the major issues in each case from each database search consumed a great deal of time. However, this was essential to obtaining a complete and accurate list of Section 501(c)(3) exemption cases. Although the final list of 389 cases was not as numerous as originally supposed, there still appears to be sufficient number to obtain substantial data from which to draw some conclusions about the behavior of charitable organizations as detailed below.

\textsuperscript{18} 75-1 USTC 9392.
\textsuperscript{19} 42 TCM 1112 (1981).
\textsuperscript{20} 79-1 USTC 9266.
\textsuperscript{21} 85-1 USTC 9316 (CA-8 1985).
\textsuperscript{22} 65-2 USTC 12,357.
Classifying the Cases

First classifying cases into four categories allows us to talk about each class in more general terms and perhaps to draw some conclusions about each class. Classifying cases in the manner described in Chapter 3 resulted in the following results:

**FIGURE 4.1**
Illegal Acts

<table>
<thead>
<tr>
<th>Loss of Exemption</th>
<th>Present</th>
<th>Absent</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A.</strong> The presence of illegal acts results in loss of exemption in 256 cases.</td>
<td><strong>B.</strong> Despite the absence of illegal acts, exemption was forfeited in 19 cases.</td>
<td></td>
</tr>
<tr>
<td><strong>D.</strong> Despite the presence of illegal acts, exemption was retained in 22 cases.</td>
<td><strong>C.</strong> Illegal acts were absent and exemption was retained in 92 cases.</td>
<td></td>
</tr>
</tbody>
</table>
See also Figure 4.2 entitled “Number of Cases in Each Class and Percent of Total.” As anticipated, cases where illegal acts resulted in loss of exemption (class A) constituted the largest number of cases and by far the largest percentage of the total body of case law (nearly two thirds). Also as anticipated, cases free of illegal acts but still resulting in loss of exemption (class B) had the smallest number of cases and smallest percentage of the total (about 5%). Cases in this class have already provided new or different insights into the law and its enforcement. Cases where illegal acts were absent and exemption was retained (class C) is also a fairly large group, representing approximately 24 percent of the total. Finally, cases where exemption was retained despite the presence of illegal acts (class D) constituted only about 6% of the total. These cases may likewise provide new or different perspectives.

FIGURE 4.2
Number of Cases in Each Class and Percent of Total

<table>
<thead>
<tr>
<th>Class A</th>
<th>Class B</th>
<th>Class C</th>
<th>Class D</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>65.80%</td>
<td>4.80%</td>
<td>23.70%</td>
<td>5.70%</td>
<td>100.00%</td>
</tr>
</tbody>
</table>

Classes A - D and Total Cases
Expanding the Typology

Because the typology of illegal acts was detailed in Chapter 3 (see Figure 3.1, page 134), it is not necessary to reiterate it here except to further define the other violation types briefly mentioned in Chapter 3. This new type is more correctly characterized as failures on the part of the organizations to take appropriate action rather than as illegal acts. These new “type 4” behaviors were identified in reviewing the cases for types of illegal acts, particularly cases where exemption was forfeited despite the absence of illegal acts (class B) and cases where exemption was retained despite the presence of illegal acts (class D). These failures to act are defined below.

Failing the Organizational Test. The exemption statute contains a two part test to obtain exemption, the organizational and operational test. The other types of illegal behaviors previously described are all related to failing the operational test of the statute. That is, the illegal act caused the organization to appear not to be operated at all times for charitable purposes. The organizational test is much more objective and measurable than the operational test. If an organization is properly incorporated or otherwise formed under local law, has organizational documents that contain certain required provisions,23 and in most cases, completes a proper application for recognition of exemption to the IRS, then they will be considered to have met the organizational test.24 Thus, it is possible for an organization to not have committed any illegal act yet, still forfeit their exempt status due to a failure to meet the organizational test of the statute.

23 e.g., All organizational documents should contain a dissolution provision that requires upon dissolution the assets of the dissolving organization be paid to some other qualifying charitable organization.

24 Treas. Reg. Section 1.501(c)-1(3).
Failure To Take Other Action To Secure Exemption. Some cases involve other failures on the part of the organization to take other corrective or required action to secure their exemption. Once again, no illegal act has occurred, but the organization nonetheless may forfeit its exemption due to its failure to act. For example, if the IRS proposes to revoke an organization's status on organizational or other grounds and that organization fails to file a timely petition or protest, they could forfeit their exempt status even if the Service's position was unfounded.

Exempt Under Other Subsection. This category includes any organization previously or preliminarily granted status as a Section 501(c)(3) organization subsequently determined to be exempt under another subsection of the exemption statute. Again, no illegal act has occurred and in this situation perhaps, no failure to act of the type described above has occurred. Nonetheless the organization may forfeit its Section 501(c)(3) status for exempt status under another section or subsection. If there was a failure in this type case it is generally that the organization has not properly defined itself, or described its purpose, character or method of operation, or has, subsequent to its original application for exemption, changed its purpose, character or method of operation to a type other than charitable.

Types and Subtypes—What the Cases Reveal

One Issue Cases. The data regarding one issue cases is imbedded in the tables and figures following, but a few summarizing comments may be useful. Of the 389 cases in the final list only 112 of those dealt with only one type of act or failure to act. See Figure 4.3 entitled “Number of One Issue Cases in Each Class and Percentage of Total One Issue Cases.” Of those 112 cases 67 were cases where the organization
retained its exemption (class C cases). Thus, a significant percentage of the total of these one issue cases were decided for the organization and a very high percentage of all cases decided for the organization were one issue cases. The next highest number of one issue cases (29) were those where illegal acts or failures to act were present and exemption was forfeited (class A), but this represents the smallest percentage of one issue cases when compared to the other classes of cases. One issue cases where exemption was lost despite the absence of illegal acts (class B) represented 47.4% of that class of cases, a high percentage. Finally 31.8% of cases where exemption was retained despite the presence of illegal acts (class D) were one issue cases. These facts are illustrated graphically in Figure 4.4 entitled “Percentage of One Issue Cases in Each Class” and in the previous Figure 4.3.

FIGURE 4.3
Number of One Issue Cases in Each Class and Percentage of Total One Issue Cases
Frequency of Violation Types—All Cases. The frequency of violation types for all cases is detailed in Appendix B and Figure 4.5 entitled “Frequency and Percentage of Violation Types for All Classes of Cases.” Private inurement (type 1) issues constituted 37.4% of the total of illegal and purported illegal acts. Exclusivity issues (type 2) were evident in 43.7% of all acts. Public benefit or public policy (type 3) was at issue 13% of the time. And failures to act (type 4) were evident 5.9% of the total.
Frequency of Violation Types and Subtypes in Each Class

Figure 4.6 entitled “Frequency and Percentage of Types of Acts or Failures to Act for Cases Where Illegal Acts Were Present and Exemption Was Forfeited,” and Table 4.1 provide the details regarding all the types and subtypes of violations in cases where illegal acts were shown to be present and exemption was forfeited (class A).
FIGURE 4.6
Frequency and Percentage of Types of Acts or Failures to Act for Class A Cases Where Illegal Acts Were Present and Exemption Was Forfeited

Figure 4.7 entitled “Frequency and Percentage of Types of Acts or Failures to Act for Class B Cases Where Illegal Acts Were Absent, but Exemption Was Lost,” and Table 4.2 provide the details of violation types and subtypes in cases when exemption was forfeited despite the absence of illegal acts (class B).

Figure 4.8 entitled “Frequency and Percentage of Types of Acts or Failures to Act–Class C Cases Where Illegal Acts Were Found to Be Absent and Exemption Was Retained,” and Table 4.3 provide the details of violation types and subtypes in cases where the entity was found not to commit illegal acts and retained exemption.
FIGURE 4.7
Frequency and Percentage of Types of Acts or Failures to Act for Class B Cases Where Illegal Acts Were Absent and Exemption Was Lost

Types 1 - 4

- Type 1 - Private Inurement 3.40%
- Type 2 - Exclusivity Violations 3.40%
- Type 3 - Public Benefit Policy 0%
- Type 4 - Failures to Act 93.20%

FIGURE 4.8
Frequency and Percentage of Types of Acts or Failures to Act for Class C Cases Where Illegal Acts Were Found to Be Absent and Exemption Was Retained

Types 1 - 4

- Type 1 - Private Inurement 28.70%
- Type 2 - Exclusivity Violations 59.10%
- Type 3 - Public Benefit Policy 7.00%
- Type 4 - Failures to Act 5.20%
Figure 4.9 entitled “Frequency and Percentage of Types of Acts or Failures to Act for Class D Cases Where Exemption Was Retained Despite the Presence of Illegal Acts.”

**FIGURE 4.9**
Frequency and Percentage of Types of Acts or Failures to Act for Class D Cases Where Exemption Was Retained Despite the Presence of Illegal Acts

The violations for all Class A cases were distributed as follows:
TABLE 4.1
Frequency of Violation Types and Subtypes for Class A Cases Where Illegal Acts Were Present and Exemption Was Forfeited
Class A Violations

<table>
<thead>
<tr>
<th>Subtypes</th>
<th>Private Inurement Type 1</th>
<th>Exclusivity Violations Type 2</th>
<th>Public Benefit Policy Type 3</th>
<th>Failures to Act Type 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>a)</td>
<td>18</td>
<td>121</td>
<td>79</td>
<td>13</td>
</tr>
<tr>
<td>b)</td>
<td>17</td>
<td>2</td>
<td>20</td>
<td>1</td>
</tr>
<tr>
<td>c)</td>
<td>53</td>
<td>67</td>
<td>-</td>
<td>0</td>
</tr>
<tr>
<td>d)</td>
<td>15</td>
<td>13</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>e)</td>
<td>20</td>
<td>71</td>
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<tr>
<td>f)</td>
<td>3</td>
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<tr>
<td>g)</td>
<td>115</td>
<td>-</td>
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<tr>
<td>h)</td>
<td>12</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<tr>
<td>i)</td>
<td>7</td>
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<tr>
<td>TOTALS</td>
<td>260</td>
<td>274</td>
<td>99</td>
<td>14</td>
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</tbody>
</table>

See also Figures 4.10, 4.11, 4.12, 4.13 entitled “Frequency and Percentage of Type 1 Private Inurement Subtypes–Class A Cases,” “Frequency and percentage of Type 2 Exclusivity Violations Subtypes–Class A Cases,” “Frequency and Percentage

25 See Typology, Figure 3.1, page 134.
of Type 3 Public Benefit Public Policy Subtypes—Class A Cases” and “Frequency and percentage of Type 4 Failures to Act Subtypes—Class A Cases” respectively.

FIGURE 4.10
Frequency and Percentage of Type 1 Private Inurement Subtypes—Class A Cases Where Illegal Acts Were Present and Exemption Was Forfeited

![Graph showing frequency and percentage of Type 1 Private Inurement Subtypes.]

Subtype a-Unreasonable Compensation 6.90%
Subtype b-Non Arm's Length Trans 6.50%
Subtype c-Retained Interests 20.40%
Subtype d-Loans 5.80%
Subtype e-Services 7.70%
Subtype f-Assumption of Liability 1.10%
Subtype g-Personal Expenses 44.20%
Subtype h-Investments 4.00%
Subtype i-Equity Distribution 2.80%

FIGURE 4.11
Frequency and Percentage of Type 2 Exclusivity Violations Subtypes—Class A Cases Where Illegal Acts Were Present and Exemption Was Forfeited

![Graph showing frequency and percentage of Type 2 Exclusivity Violations Subtypes.]

Subtype a-Tax Avoidance 44.10%
Subtype b-Partnerships or J.V.’s 1.00%
Subtype c-Exempt Purpose Forgotten 24.40%
Subtype d-Lobbying or Political Action 4.70%
Subtype e-Commercial or Unrelated Activity 25.80%
FIGURE 4.12
Frequency and Percentage of Type 3 Public Benefit Public Policy Where Illegal Acts Were Present and Exemption Was Forfeited

| Subtype a - Insufficient Public Benefit | 79.80% |
| Subtype b - Against Public Policy | 20.20% |

FIGURE 4.13
Frequency and Percentage of Type 4 Failures to Act Subtypes - Class A Where Illegal Acts Were Present and Exemption Was Forfeited

| Subtype a - Organizational Test Failure | 92.80% |
| Subtype b - Other Action Failure | 7.20% |
| Subtype c - Exempt Under Other Subsection | 0.00% |
The violations for all Class B Cases were distributed as follows:

### TABLE 4.2
**Frequency of Violation Types and Subtypes for Cases Where Exemption Was Forfeited Despite the Absence of Illegal Acts**
**Class B Violations**

<table>
<thead>
<tr>
<th>Subtypes</th>
<th>Private Inurement Type 1</th>
<th>Exclusivity Violations Type 2</th>
<th>Public Benefit Public Policy Type 3</th>
<th>Failures to Act Type 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>a)</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>17</td>
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<tr>
<td>b)</td>
<td>1</td>
<td>1</td>
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<td>8</td>
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<tr>
<td>c)</td>
<td>0</td>
<td>0</td>
<td>-</td>
<td>2</td>
</tr>
<tr>
<td>d)-i)</td>
<td>0</td>
<td>d)&amp;e) 0</td>
<td></td>
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</table>

**TOTALS** 1 1 0 27

See Figure 4.14 entitled “Frequency and Percentage of Type 4 Failures to Act Subtypes—Class B Cases Where Exemption Was Forfeited Despite the Absence of Illegal Acts.” Private inurement and exclusivity violations for these cases were not graphed since there was only one of each of these types and there were no type B public benefit public policy violations.

---

26 See Typology, Figure 3.1, page 134
FIGURE 4.14
Frequency and Percentage of Type 4 Failures to Act—Class B Cases Where Exemption Was Forfeited Despite the Absence of Illegal Acts

Subtype a-Organizational Test Failure 63.00%
Subtype b-Other Action Failure 29.60%
Subtype c-Exempt under Other Subsection 7.40%
The violations for all Class C cases were distributed as follows:

**TABLE 4.3**
Frequency of Violation Types and Subtypes for Cases Where Illegal Acts Were Absent and Exemption Was Retained
Class C Violations

<table>
<thead>
<tr>
<th>Subtypes(^{27})</th>
<th>Private Inreemnt Type 1</th>
<th>Exclusivity Violations Type 2</th>
<th>Public Benefit Public Policy Type 3</th>
<th>Failures to Act Type 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>a)</td>
<td>13</td>
<td>3</td>
<td>8</td>
<td>4</td>
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<tr>
<td>b)</td>
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<td>1</td>
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<tr>
<td>c)</td>
<td>3</td>
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<td>1</td>
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<tr>
<td>d)</td>
<td>1</td>
<td>2</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>e)</td>
<td>9</td>
<td>63</td>
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<tr>
<td>f)</td>
<td>0</td>
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<td>g)</td>
<td>0</td>
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<td></td>
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<tr>
<td>h)</td>
<td>5</td>
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</tr>
<tr>
<td>i)</td>
<td>0</td>
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<td><strong>TOTALS</strong></td>
<td>22</td>
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<td>6</td>
</tr>
</tbody>
</table>

\(^{27}\) See Typology, Figure 3.1, page 134
See Figures 4.15, 4.16, 4.17 and 4.18 entitled “Frequency and Percentage of Type 1 Private Inurement Subtypes—Class C Cases,” “Frequency and Percentage of Type 2 Exclusivity Violations Subtypes—Class C Cases,” “Frequency and Percentage of Type 3 Public Benefit Public Policy Subtypes—Class C Cases” and “Frequency and Percentage of Type 4 Failure to Act Subtypes—Class C Cases” respectively.

FIGURE 4.15
Frequency and Percentage of Type 1 Private Inurement Subtypes—Class C Cases Where Illegal Acts Were Absent and Exemption Was Returned

Private Inurement Type 1 - Subtypes a - i
FIGURE 4.16
Frequency and Percentage of Type 2 Exclusivity Violation Subtypes—Class C Where Illegal Acts Were Absent and Exemption Was Retained

![Exclusivity Violation Type 2 - Subtypes a - e](image)

- Subtype a - Tax Avoidance 4.40%
- Subtype b - Partnerships of J.V.'s 0.00%
- Subtype c - Exempt Purpose Forgotten 0.00%
- Subtype d - Lobbying or Political Action 2.90%
- Subtype e - Commercial or Unrelated Activity 92.70%

FIGURE 4.17
Frequency and Percentage of Type 3 Public Benefit Public Policy Subtypes—Class C Cases Where Illegal Acts Were Absent and Exemption Was Retained

![Public Benefit Type 3 - Subtypes a and b](image)

- Subtype a - Insufficient Public Benefit 100.00%
- Subtype b - Against Public Policy 0.00%
FIGURE 4.18
Frequency and Percentage of Type 4 Failure to Act Subtypes—Class C Cases Where Illegal Acts Were Absent and Exemption Was Retained

Failures to Act Type 4 - Subtype a - c

- Subtype a - Organizational Test Failure 66.70%
- Subtype b - Other Action Failure 16.60%
- Subtype c - Exempt Under Other Subsection 16.70%
The violations for all Class D cases were distributed as follows:

**TABLE 4.4**
Frequency of Violations for Cases Where Illegal Acts Were Present and Exemption Was Retained
Class D Violations

<table>
<thead>
<tr>
<th>Subtypes</th>
<th>Private Inurement Type 1</th>
<th>Exclusivity Violations Type 2</th>
<th>Public Benefit Public Policy Type 3</th>
<th>Failures to Act Type 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>a)</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>b)</td>
<td>3</td>
<td>5</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>c)</td>
<td>1</td>
<td>2</td>
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<td>0</td>
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<tr>
<td>d)</td>
<td>2</td>
<td>3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>e)</td>
<td>4</td>
<td>10</td>
<td></td>
<td></td>
</tr>
<tr>
<td>f)</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>g)</td>
<td>3</td>
<td></td>
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<tr>
<td>h)</td>
<td>3</td>
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<tr>
<td>i)</td>
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<tr>
<td>TOTALS</td>
<td>18</td>
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<td>1</td>
<td>2</td>
</tr>
</tbody>
</table>

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28 *See Typology, Figure 3.1, page 134*
See also Figures 4.19 and 4.20 entitled "Frequency and Percentage of Type 1 Private Inurement Subtypes—Class D Cases" and "Frequency and Percentage of Type 2 Exclusivity Violation Subtypes—Class D Cases (only 1 Type 3(b) and 2 Type 4(a) subtypes)." No graphs were prepared for public benefit public policy or failure to act violation types since there were only one and two of those instances respectively in these cases.

**FIGURE 4.19**

*Frequency and Percentage of Type 1 Private Inurement Subtypes—Class D Cases Where Exemption Was Retained Despite the Presence of Illegal Acts*

<table>
<thead>
<tr>
<th>Subtype</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>a-Unreasonable Compensation</td>
<td>5.50%</td>
</tr>
<tr>
<td>b-Non Arms Length Trans.</td>
<td>16.70%</td>
</tr>
<tr>
<td>c-Retained Interests</td>
<td>5.50%</td>
</tr>
<tr>
<td>d-Loans</td>
<td>11.10%</td>
</tr>
<tr>
<td>e-Services</td>
<td>22.30%</td>
</tr>
<tr>
<td>f-Assumption of Liability</td>
<td>5.50%</td>
</tr>
<tr>
<td>g-Personal Expense</td>
<td>16.70%</td>
</tr>
<tr>
<td>h-Investments</td>
<td>16.70%</td>
</tr>
<tr>
<td>i-Equity Distribution</td>
<td>0.00%</td>
</tr>
</tbody>
</table>

Private Inurement Type 1 - Subtypes a - i
FIGURE 4.20
Frequency and Percentage of Type 2 Exclusivity Violation Subtypes—Class D Cases Where Exemption Was Retained Despite the Presence of Illegal Acts

Distribution of Persons Engaged in Illegal Acts

Previewing cases for who perpetrated these acts can provide a distribution of persons from which some conclusions might be drawn. While the categories of persons are fairly discrete, there is some overlap. For instance, most founders would also generally be officers or directors. Similarly, independent contractors might also be consultants or vice versa. However, in developing the distribution these overlaps were limited by limiting each category to specific persons in order not to skew the data. For instance persons providing personal services of a type generally provided by an employee, but who were not employees were classified as independent contractors. Consultants included non-employee persons providing professional services such as
legal, accounting or similar services. Founders, if identified as such in a case, were not also included as an officer or director even if also identified as such.

It is apparent from the completed Table 4.5 and the figures with the same title as this subsection (one for each type 1 private inurement and type 2 exclusivity violations), founders and family members constituted by far the two largest groups of violators in cases dealing with both Type 1 private inurement and Type 2 exclusivity violations. Founders were involved in 90.2% of the instances of Type 1 acts and 92.2% of Type 2 acts. Family members were involved in 48.2% of all Type 1 private inurement instances, but none of the Type 2 instances. Interestingly, unrelated persons in total accounted for only 1.8% of the total Type 1 private inurement instances and 2.34% of Type 2 exclusivity violations instances. Facts about the other categories of persons are summarized in Table 4.5 and Figures 4.21 and 4.22.
FIGURE 4.21
Frequency and Percentage of Persons Engaged in Type 1 Private Inurement Acts

1. Other Unrelated Outsiders, 0.40%
2. Other Outsider Investors, 1.40%
3. Ind. Contractor Outsiders, 0.00%
4. Consultant Outsiders, 0.00%
5. Other Related Insiders, 5.40%
6. Family Members of Insiders, 48.20%
7. Employees, 2.90%
8. Officers, 4.70%
9. Directors, 3.60%
10. Founders, 90.20%
FIGURE 4.22
Frequency and Percentage of Persons Engaged in Type 2 Exclusivity Violations

1. Other Unrelated Outsiders, 1.00%
2. Other Outsider Investors, 1.00%
3. Ind. Contractor Outsiders, 0.34%
4. Consultant Outsiders, 0.00%
5. Other Related Insiders, 4.40%

6. Family Members of Insiders, 0.00%
7. Employees, 0.00%
8. Officers, 0.00%
9. Directors, 0.00%
10. Founders, 92.20%
### TABLE 4.5
Distribution of Persons Engaged in Illegal Acts

<table>
<thead>
<tr>
<th>Persons</th>
<th>Totals</th>
<th>(a)</th>
<th>(b)</th>
<th>(c)</th>
<th>(d)</th>
<th>(e)</th>
<th>(f)</th>
<th>(g)</th>
<th>(h)</th>
<th>(i)</th>
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<td>INSIDERS</td>
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<tr>
<td>Founders</td>
<td>251/279</td>
<td>10</td>
<td>15</td>
<td>54</td>
<td>15</td>
<td>17</td>
<td>4</td>
<td>118</td>
<td>12</td>
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<tr>
<td>Directors</td>
<td>10/279</td>
<td>2</td>
<td>4</td>
<td>1</td>
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<tr>
<td>Officers</td>
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<td>3</td>
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<tr>
<td>Employees</td>
<td>3/279</td>
<td>3</td>
<td>2</td>
<td>1</td>
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<tr>
<td>Family Members</td>
<td>134/279</td>
<td>6</td>
<td>5</td>
<td>10</td>
<td>9</td>
<td>3</td>
<td>95</td>
<td>3</td>
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<td>Other related parties</td>
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<td>Consultants</td>
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<td>Other investors</td>
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<td><strong>EXCLUSIVITY VIOLATIONS</strong></td>
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<td>INSIDERS</td>
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<td>Officers</td>
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<td>2</td>
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<td>Consultants</td>
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</tr>
</tbody>
</table>
Type 3 public benefit public policy violations and Type 4 failures to act were not analyzed for who in those cases was involved or who perpetrated an illegal act or failure to act. Both the Type 3 and 4 categories fail to offer the same kinds of discrete acts found in cases involving Type 1 private inurement and Type 2 exclusivity violations. Thus, it is impossible in most cases involving Type 3 or 4 issues to identify who failed to act appropriately or failed to cause the organization to act appropriately. Although it seems founders, directors, trustees and officers set policy of the type dealt with in cases involving Type 3 issues and also often guide the organizations in ways so as to constitute Type 4 violations, this issue was not documented in the case law. Therefore, any conclusions about who perpetrated these acts would be pure conjecture.

Changes in Distributions of Class and Type Over Time

Reviewing the changes in distributions over time can provide important information about trends in enforcement. The distributions are detailed in Table 4.6 and in Figures 4.23, 4.24, 4.25 and 4.26. However, summary comments are appropriate. Reviewing the numbers decade by decade provides substantial information about the frequency of the various subtypes of illegal acts or failures to act. In the decade between 1954 and 1963, subtype 2(e), commercial activity was a frequent issue. Cases also frequently dealt with subtype 1(g) acts involving the payment of personal expenses, a type of private inurement. Close behind were type

\[29\] See e.g., Bob Jones University, 81-1 USTC 9124, aff'd 83-1 USTC 9366 (Sup. Ct. 1983), or Green, W.H. v. Miller, 80-1 USTC 9401 (DC 1980).
2(c) instances, where there was evidence of an exempt purpose being forgotten or abused. The other subtypes were fairly well distributed.

TABLE 4.6

Incidence of Violation Types over Time

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
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<td>Type 1</td>
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<tr>
<td>(c)</td>
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<td>(d)</td>
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<td>(i)</td>
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<td>(b)</td>
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<td>(c)</td>
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<td>(d)</td>
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<td>(e)</td>
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<td>11</td>
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<tr>
<td>(b)</td>
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<td>(c)</td>
<td>1</td>
<td>0</td>
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FIGURE 4.23
Frequency of Act Subtypes Over Time

- Type 1(a) Unreasonable Comp.
- (b) Non Arm's Length
- (c) Retained Interest
- (d) Loans
- (e) Services
- (f) Assumption of Liability
- (g) Personal Expense
- (h) Investments
- (i) Equity Distribution
- Type 2(a) Tax Avoidance
- (b) Partnerships or J.V.s
- (c) Exempt Purpose Forgotten
- (d) Lobbying or Political Action
- (e) Commercial or Unrelated Activity
- Type 3(a) Insuff. Public Benefit
- (b) Against Public Policy
- Type 4(a) Organizational Test Failure
- (b) Other Action Failure
- (c) Exempt Under Other Subsection
Some summary comments about these results may be useful. For instance, between 1964 and 1973 there were fewer exemption cases decided. It is unknown as to why, however. It is possible decreased IRS funding or changes in enforcement strategies or priorities caused the Service to contract their efforts on these issues temporarily. No evidence of a conscious contraction could be located. It is logical to assume that the congress and the president were applying pressure on the service to direct their efforts towards those areas that maximized tax collections in order to finance the expansive and protractive war in Vietnam. In the cases decided in this decade the largest percentage of all acts or failures to act dealt with type 2(c) issues of a forgotten or abused exempt purpose. This is by far the highest percentage act of that decade. The other acts were fairly evenly distributed.

Between 1974 and 1983 there were nearly 5 times as many illegal acts in exemption cases as the prior decade. The frequency of illegal acts involving retained interests in gifts from founders and others continued to rise (3.7% to 4.6% to 7.5% to 9.5% in ‘84 to ‘94). There were sharp increases in private inurement subtype 1(g) incidences dealing with the payment of personal expenses to 12.7% of the total, exclusivity subtype 2(a) dealing with tax avoidance motives to 14.9%, and public benefit public policy subtype 3(a) cases with issues of insufficient public benefit increasing to 12.3% of total incidences. There were sharp decreases in exclusivity issues where the organization forgot or abused its exempt purpose (subtype 2(c)) and in cases involving issues of public policy (subtype 3(b)).

In the decade between ‘84 and ‘94 the total number of illegal acts jumped by nearly 47% to 335 incidences. Private inurement subtype 1(c) acts continued to rise,
as indicated above, as did private inurement subtypes 1(g) personal expenses (to 21.4%) and 2(a) tax avoidance schemes (to 22.4% the largest group of all subtypes). Over the entire 4 decade period some patterns do arise. See Figure 4.24 entitled “Percentages of Types of Acts Over Time.” There was a decrease in the importance of private inurement cases from 42.4% of the total to 37.2%, then to 34.4%, and finally making a slight comeback to 40.5%. Type 2 exclusivity violations increased steadily as a percentage of the total from 40.7% in ‘54 to ‘63, to 41.8%, to 41.9% to 42.3%. Type 3 public benefit/public policy cases increased substantially as a percentage of the total between the first and second decades studied (from 10.2% to 18.6%) but then began a decline (to 14.9% in ‘74 to ‘83 and further to 13.4% in ‘84 to ‘94). Type 4 failures to act fluctuated from decade to decade (6.4% to 2.3% to 8.8% to 4.2%) but on average remained fairly constant at around 5%.

FIGURE 4.24
Percentage of Types of Acts Over Time

![Graph showing percentage of types of acts over time](image-url)
Examining data regarding the classes of cases decided in each decade also provides information about trends over the 40 year period. See Figures 4.25 and 4.26 entitled “Number of Each Class of Case Decided in Each Decade” and “Percentage of Cases Decided in Each Decade in Each Class.” Class A cases, those decided against the organization, increased steadily and substantially over the entire period from 39.3% to 55.6% to 64.8% and finally to 83.3% of all cases. This suggests it has become increasingly difficult for the organization to succeed in litigating these issues against the IRS. This is further supported by the steady and significant decline in the number and percentage of Class C (those decided for the organization) cases over the entire 40 year period. As a percentage of the total, Class C cases decreased from 44.0% to 37.0% to 23.4% to only 10.0% of the total. Finally Class D cases wherein illegal acts went unpunished decreased steadily and substantially as expected from 11.9% of the total to 7.4% to 5.6% to only 2.0%. All this suggests that cases are becoming increasingly complex, with fewer and fewer single issue cases. Considering the large number of small organizations, these trends might produce a built in advantage for the government in litigating these increasingly complex cases. There will be more about this later.
FIGURE 4.25  
Number of Each Class of Case Decided in Each Decade

FIGURE 4.26  
Percentage of Cases Decided in Each Decade in Each Class
Distribution of Public versus Private Charities

It was suggested in Chapter 3 that exemption cases involving private foundations might increase after the 1969 Tax Reform Act. However, the opposite trend occurred. The 1969 Tax Reform Act, the most sweeping piece of legislation ever affecting charitable organizations, appears to have had a positive effect on the behavior of private foundations, that is, fewer instances of abuse. Throughout the 1950s and early 1960s there was substantial study and debate about the abuses being perpetrated by private foundations which led to the passage of the '69 Reform Act. This was discussed in some detail in Chapter 2. Although the act did not change the exemption requirements, it offered more graduated levels of responses to illegal acts while still allowing that exemption could be stripped for especially egregious instances.

Many of the Act's provisions aimed at stemming illegal acts by private charities appear to have succeeded in large part. Over the 40 year study period the percentage of exemption cases involving private foundations decreased steadily and substantially and those involving public charities increased steadily. See Figure 4.27 entitled "Percentage of Cases Involving Illegal Acts by Public and Private Charities Over Time." The percentage of the total number of Class A and D cases, those where illegal acts are known to have occurred, which involved private charities was 39.0% during the first study decade then decreased to 35.3% in the next, 10.3% in the next and constituted only 7.3% in the last. Correspondingly those Class A and D cases involving public charities increased steadily from 61.0% of the total in '54 to '64 to


\[^{31}\text{Id.}\]
64.7%, to 89.7% to 92.7%. Although the growth of public charities has been more rapid than private charities, this trend suggests that public policy or tax policy can have an important impact on the behavior of organizations. This trend provides encouragement for adoption of new initiatives to stem perceived abuses.

**TABLE 4.7**

Public versus Private

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<td><strong>Public Charities</strong></td>
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<td>Class A</td>
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<td><strong>Private Charities</strong></td>
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</tr>
<tr>
<td>Class A</td>
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<td>9</td>
</tr>
<tr>
<td>Class D</td>
<td>6</td>
<td>1</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td><strong>TOTALS</strong></td>
<td>41</td>
<td>17</td>
<td>97</td>
<td>123</td>
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</tbody>
</table>

Class A cases include those where illegal acts were present and exemption was forfeited. Class D are those where illegal acts were present and exemption was retained.
Thus, from the case law one new type of violation (that is failures to act) was identified which was not previously discussed in any detail in the literature as a major issue for nonprofits. Five characteristics or behavior issues common to all classes of cases decided in the last 40 years were highlighted including tax avoidance schemes; burden of proof issues; related party transactions; multiple issues/complexity; and commercial or unrelated activity. One characteristic common primarily to cases with loss of exemption despite no evidence of illegal acts (class B cases) was also identified—that is organization and application issues. Each behavior problem appears to be indicative of ineffective legal and other criteria and each appears to provide an
opportunity for the development or suggestion of new administrative procedures, practice standards, regulations or tax legislative policy.

It appears also, that some early suppositions were incorrect. For instance, in Chapter 3, it was anticipated that public policy cases might constitute a larger proportion of the total in the last 10 years than in any other decade. However, public policy/public benefit Type 3 cases actually reached their peak as a percentage of total cases (18.6 percent) in the decade between '64 and '73 and have since that time decreased substantially as a percent of the total (to 13.4 percent).

Chapter 5 will further review these findings and will discuss what policy making conclusions, regulatory or legislative action, new enforcement mechanisms or practice standards might be effective in dealing with these issues. In addition Chapter 5 will suggest how these conclusions might be generalized to broader constituencies to improve policy or enforcement for other noncharitable nonprofits. Chapter 5 will also review existing legislative proposals in light of the findings to assess their potential effectiveness and where those initiatives might have missed the mark. Finally, Chapter 5 will address again the issue of a theory of charity, pointing out areas for possible additional study.
CHAPTER 5

CONCLUSIONS

Introduction

[T]he role played by nonprofit organizations is not only desirable but may very well be a prerequisite to the continuation of a democratic society. It is through such institutions that we harness the energies and finances of our private citizens to humane, experimental, creative, and controversial purposes . . . . It affords our citizens the opportunity to participate in public service while maintaining private employment. It organizes parts of our society for social purposes through nongovernmental means where governmental action is inappropriate, would be inconsistent with our way of life or is not possible because the purpose is too controversial. It allows individuals to voluntarily tax themselves in time and money . . . according to their individual preferences . . . . It provides a unique and flexible form of social organization that counterbalances the vast power of government and concentrated wealth of the private sector. Therefore, in regulating the conduct of the exempt sector and in its provisions for tax benefits, the purpose of government should be to maintain a maximum of freedom of action . . . .

While many might agree with Professor Stone on the benefits of nonprofit organizations, there is a large and growing segment of the population calling for

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additional restriction of the freedoms of these organizations. Although the nonprofit sector agrees, as Professor Stone opines, that maximum freedom is necessary, the sector has done next to nothing to police itself. If a broad cross-section of the sector cannot agree upon new and more effective practice standards, the alternative is government intervention such as new administrative procedures, regulations and/or legislation.

It may well be extremely difficult to deal in the abstract with practice standards, enforcement mechanisms, regulation and tax legislative policy for the whole of the nonprofit sector, however, it is possible to discuss ways to deal with the specific behavior problems identified in this study. But before that can be undertaken it is necessary to discuss what the research reveals about present law, theory and the literature. Specifically, what links can be made between the analysis of the case law and the state of these three elements that informed the analysis? This chapter will undertake to answer this question. Then, information about the specific behavior problems identified in the case law will be reviewed followed by a discussion of alternatives to existing practice standards, enforcement mechanisms, regulation and tax legislative policy suggested by the litigation. It may also be possible to generalize some of these conclusions to improvements for the entire sector. This would include a review of current legislative initiatives under consideration perhaps identifying what

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2Eisenberg, Pablo, Charities' Response to Criticism: Business as Usual, 9-6 THE EXEMPT ORGANIZATION TAX REVIEW 1214, 1215 (June, 1994) (“[T]he public will not so easily tolerate further disclosures of excessive compensation packages, unethical practices, and refusal to be accountable.”). See also, Emshwiller, John R., More Small Firms Complain About Tax Exempt Rivals, WALL ST. J., Aug. 8, 1995, at B1.

3Eisenberg, supra note 2.
shortcomings, if any, that proposed legislation might possess. Finally, possible areas of additional study of nonprofits behaviors will be discussed.

What the Research Reveals About the Law

The analysis of the case law provides significant insight into the inadequacies of present law, regulation and the enforcement thereof. The present legal criteria in the statute are incomplete, and wholly inadequate to the task of defining the sector. The regulations and other administrative pronouncements are similarly unclear or conflicting and this has led to inconsistent judicial rulings.

The development of the violation typology provides accreditation to this conclusion. The present law includes very broad inurement prohibitions, exclusivity prohibitions (including specific prohibitions against political action and minimal lobbying activity) and organizational requirements. It does not provide any guidance as to the various types of private inurement violations and is silent as to many of the other types of violations discovered and included in the Typology of Violations at Figure 3.1. For instance, subtype 2(a), tax avoidance schemes, subtype 2(b), partnerships and joint ventures, subtype 2(c), failure to practice exempt purposes, subtype 3(b), public policy violations, and subtype 4(b), other failures to act, are not part of the present statute or regulations. Many of these violations were the ones generating the largest share of the litigation (e.g. 17.5% of all cases in the 40 study period were tax avoidance cases), yet the statute is silent. These violation subtypes were derived directly from the case law included in the analysis. For instance, the issue of partnerships or joint ventures as exclusivity violations is derived in large part
from the Plumstead Theatre Society case;⁴ the prohibition against adoption of policies in conflict with settled public policy arose out of Bob Jones University;⁵ and violations involving insufficient public benefit were evident in United Cancer Council.⁶

The result is "... a considerable degree of inconsistency ... particularly at the boundary between serving an interest that is specific, but still deemed 'public' in character and serving an interest that is deemed too narrow, though having a public interest."⁷ This "... lack of a systematic set of rules for determining what types of organizations qualify for exemption under the existing standard ..."⁸ forces these issues to constantly be litigated with varying results. For example, in Big Mama Rag the court held the regulation defining educational organizations to be "unconstitutionally vague" and allowed exemption to an organization later held to be operating against public policy.⁹ This is not an efficient use of the limited resources available to the IRS or the courts when Congress could simply eliminate many of these


⁶ United Cancer Council, Inc. v. Commissioner, 100 TC No. 11, 93 TNT 57-19 (1993).


⁸ Id.

⁹ 79-1 USTC 9362, rev'd 80-2 USTC 9674.
gray areas by clarifying the statute. Interestingly some of the same conclusions were
reached by IRS Counsel when in Litigation Guideline Memorandum TL-11 (January
22, 1988) it was concluded that a “[r]eview of briefs with IRC Section 501(c)(3)
issues has revealed some confusion over the organizational and operational
requirements of that section. . . . [It] stems from arguably ambiguous regulatory
language, seemingly inconsistent judicial development and insufficient administrative
clarification.”

While it may not be possible for the statute to cover every type or subtype of
violation, it could be more specific. There is a danger in getting too specific, however.

No set of rules can legislate morality . . . . The intent of
detailed rules can often be frustrated more easily than broader
principles . . . . I believe the current rules are adequate for those
inclined to apply good faith in their application. On the other hand, no
rules will suffice for those not so inclined.10

Regulation can only take us so far. Because all human enterprise involves
humans, mistakes will be made and judgment is necessary in dealing with those
mistakes. It is impossible to legislate against every possible eventuality.
Unfortunately, the modern mind set is “there ought to be law” to address every
permutation, every aberration, every contingency. Such a high degree of specificity is
not feasible if charity is to be encouraged. However, the statute should not be so
broad so as to encourage abuse either. What is needed is a balance that the research
has shown to be lacking.

10Yogus, Patrick I., Action Recommendations from Prominent Not-for-profit
Organizations—American Cancer Society, PHILANTHROPY MONTHLY, Jan./Feb. 1994,
at 21.
What the Research Reveals About the Literature

The literature defining the crisis is anecdotal in nature, lacking statistical or empirical support and, most importantly, it is in large part misdirected and wrong. This conclusion is directly supported by the research in this analysis. In fact, the incidence of exemption cases and illegal acts is down substantially in proportion to the growth of the sector. This may be due in part to changing IRS priorities, funding levels, changing societal demands or various other factors, but the fact remains that these incidences are down not up.

There were 5 cases finally adjudicated in 1994 when there were over 500,000 charitable organizations while in 1954, when only about 100,000 charitable organizations were in existence, 4 cases were decided. The number of illegal acts litigated when compared to the number of organizations is not material at any time during the 40 year study period. For example, there were 108 separate illegal acts in the litigation between 1954 and 1963 when only about 100,000 of these organizations existed, a percentage of about 11 one hundredths of one percent. While between 1984 and 1994 there were 335 individual instances in the cases when over 500,000 organizations existed, a percentage of only about 6 one hundredths of one percent. Although in absolute numbers there was a substantial increase in the number of illegal acts, this is most likely due to the increase in the number of organizations and the increasing complexity of the cases themselves. However, the incidence of these acts in proportion to the number of organizations is down by almost one half. Thus, it would be in error to conclude as some of these authors did\(^\text{11}\) that these problems are pervasive and increasing.

\(^{11}\) See generally, Gaul and Borowski, supra.
What the Research Reveals About Theory

Although exemption theory has been fairly well developed and debated, it remains incomplete and thus, inadequate to the task of defining such a diverse and dynamic group of entities. Economic efficiency by itself, is not a sufficient criterion to justify exemption.¹² In any case, conditioning exemption on a judgment by the IRS on "... whether capital investment among nonprofit firms in particular industries has exceeded the efficient level ..." is not administratively feasible.¹³ What the proper justification might be is yet to be discovered.

[W]e continue to lack a clear rational (sic) for the exemption. This was . . . understandable and acceptable when the nonprofit sector was small and nonprofit organizations were engaged largely in activities of a traditionally charitable nature. Today, however, the nonprofit sector represents a substantial and growing share of the national economy. Nonprofit firms now commonly provide goods and services in direct competition with profit-seeking firms, and in many cases increasingly resemble their for profit competitors in their manner of organization and operation. The traditional criteria for applying the exemption are, as a result, being stretched beyond recognition, so that the absence of an underlying rationale for those criteria, and indeed for the exemption in general, is becoming increasingly conspicuous.¹⁴

¹² Riley v. National Federation of the Blind of N. C., Inc., 108 S. Ct. 2667 (1988) ("Charities cannot and should never be judged on the basis of their financial efficiency alone. Charities represent causes, ideas, concepts, and frequently offer an approach, if not a solution, to problems in contemporary society.").


¹⁴ Id. at 54 (footnotes omitted).
It is this stretching of the traditional criteria that may have led to some of the current criticism.\textsuperscript{15} The lines between the sectors, that is business, government and the nonprofit sectors, have become increasingly blurred making it difficult in many cases to differentiate between organizations with similar purposes but chartered in one sector or the other.\textsuperscript{16} For example, many hospitals, day care centers, nursing homes, health maintenance organizations, health clubs, counseling or treatment facilities, and other supposedly charitable nonprofits who rely primarily on service fee revenue, cannot be distinguished in any significant way from similar for-profit or governmental endeavors.\textsuperscript{17} Their fee structures are similar, their pay and benefits are similar, the nature and scope of their services are similar. What \textit{should} set them apart, but often does not, is that the nonprofit should be offering services of a kind or quality unavailable from business or government or, should be making common services available to a public that neither business or government can or would, if they could, serve.\textsuperscript{18}

Whether the current exemption mechanism and its inherent indirectness is appropriate, or whether it is in lieu of other more direct subsidies or not, seems

\textsuperscript{15}See e.g., United Cancer Council, Inc. v. Commissioner, 100 TC No. 11, 93 TNT 57-19 (1993).


\textsuperscript{17}Hansmann, Henry, \textit{Trouble Spots in the Law Affecting Nonprofit Organizations}, in RESEARCH AGENDA: LEGAL ISSUES, supra note 7, at 7 ("The legal definition of 'charity' is today quite confused.").

irrelevant for the most part, since that is the current mechanism of choice. It is an "... artifact of the present tax system." Nonetheless, discovery of the appropriate rationale would help further define the sector and defend it from attack.

The case law suggests a reexamination of theoretical justifications for exemption is appropriate. What the case law in this analysis suggests is the need for a justification that takes account for the public goods issue; that is, it may no longer be enough to just meet the technical requirements of the exemption statute. While current theory and practice might reflect at least indirectly "... a desire to promote the helping of others [as well as] ... a healthy agnosticism about how that help can best be given ..." it does not sufficiently take account for the charity of charities. This conclusion is validated by examination of any number of the cases in the body of case law. For example, in the Taxation With Representation case the organization met the technical requirements of the exemption statute and accordingly, was granted exemption. It was later stripped of that exemption because its primary purpose of providing for public representation at discussions of federal tax issues was not deemed to be a charitable activity in the generally accepted sense of the term. In another

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20 Id. at 51.

21 Id.


23 Id.
case, the Hamilton County Good Government League was allowed to retain its exemption despite the presence of lobbying and political activity. In Frank F. Truscott, et. al., Trustees of Harry D. Holloway Foundation, the organization was found to be exempt despite the fact the foundation provided retirement benefits for employees of a related corporation, a decidedly noncharitable purpose. In National Alliance, the organization was denied exemption on public policy grounds but it met the statutory requirements for exemption. In Sound Health, the organization qualified for exemption despite limiting the provision of its services to members. The courts' confusion over the meaning of charitable or educational may thus, contribute to the opportunity for and perception of abuse.

Just how the public goods issue might manifest itself in theory in the future is not clear. Some authors have attempted to resolve this issue by suggesting a donative element in an organization’s income is essential in order to justify exemption. This approach and its shortcomings were discussed in some detail in Chapter 2. Perhaps the nondistribution constraint is as close as theory and practice can get to a legal definition of other-regarding love. This analysis was not undertaken to resolve and cannot begin to answer this question but does provide support for the need for additional analysis.

24 Seasongood, Murray, 22 TC 671, rev’d and rem’d 56-1 USTC 9135 (CA-6, 1955).


26 81-1 USTC 9464, rev’d and rem’d 83-2 USTC 9434 (CA-DC, 1983).


Summarizing Common Characteristics

Introduction

This section of the analysis summarizes the behavior problems and patterns identified in the body of case law. Before alternative practice standards, enforcement mechanisms or legislative options can be discussed it is necessary to understand the nature and scope of the behavior problems and whether or not there are any clues to appropriate responses evident in the litigation.

Churches and Tax Evasion

The research shows there to be a major problem related to the use of churches to perpetrate an evasion of income taxes. More than one fourth of all cases where illegal acts cost the organization its exemption (class A cases–68/256) involved tax evasion schemes by persons under the guise of religiosity. This represents almost 17.5 percent of all exemption cases decided in the last 40 years. More than one half of these cases involving churches and tax evasion were decided in the last five years (37) and nearly 80 percent (54) were decided in the last ten years. In most instances, this represents a violation (Type 2(a) tax avoidance schemes) of the exclusivity portion of the exemption statute. This violation subtype (tax avoidance schemes) accounted for the second largest number of all violation subtypes (124) and constituted 34 percent of all Type 2 exclusivity violations and 15 percent of all violations.
Many of these cases are so obviously evasion, its surprising they even went to trial. For instance, in Peterson\textsuperscript{29} a commercial airline pilot claimed to have made gifts to a "church" of which he was the sole member; he paid personal living expenses from a "church account"; and had never performed any religious functions or services. This is a perversion of the tax law for personal gain.

Another example just as obvious occurred in Rode\textsuperscript{30} wherein the court found the taxpayer's so-called church was nothing more than a sham and that income derived under its auspices was taxable to the founder. The "church" had no substance, no evangelical activities, no missionaries, and no sacerdotal or religious services or functions. Its income and assets were devoted to purchasing cars and a motorhome for the founder and paying other clearly personal expenses.

In King Shipping\textsuperscript{31} a church was set up to hide income from illegal activities. The founder and his friends were smuggling illegal drugs into this country and funneling the sales through church accounts to avoid detection. However, there was no substance to the church, its income and assets were used for the personal living expenses of its founder and his friends and it was stripped of its exemption.

In Synanon Church\textsuperscript{32} there was substantial evidence of personal gain and purposes being served although the organization was denied exemption on public

\textsuperscript{29}91 TNT 171-16, TCM 91-399 (1991).


\textsuperscript{31}King Shipping Consum., Inc. v. Commissioner, 58 TCM 574 (1989).

\textsuperscript{32}84-1 USTC 9213, aff'd 87-1 USTC 9347.
policy grounds. The founder and others received unreasonable compensation (over $2 million to the founder and $7 million in total to the staff), they destroyed evidence, and were ultimately convicted of conspiracy to commit murder.

In Canada the “Kneadmore Life Church” was denied exemption because it paid personal expenses, including providing housing, food, and transportation. The organization had no charitable purpose, clearly did not operate for solely charitable purposes and so properly forfeited its exemption.

It is apparent that the existing sanctions against these activities are insufficient to discourage such obvious attempts to evade taxation. Negligence and/or civil fraud penalties are often as far as the punishment goes, and withdrawing exemption has long been only a last resort of the IRS in dealing with many errant organizations. Churches are not even required to apply for exemption or file annual information returns making the identification of errant organizations that much more difficult for the Service. The case law suggests that strengthening fraud penalties, changing burden of proof requirements and requiring applications and annual returns might be 

\[33\] 82 TC 973, 981 (1984).

\[34\] See, Summary of Treasury Intermediate Sanctions Proposal, 9 EXEMPT ORGANIZATION TAX REVIEW 803 (April, 1994) (“Intermediate sanctions would be ‘the sole sanction’ - i.e., the IRS would not revoke exempt status - unless the excess benefit ‘is so egregious’ that ‘the organization no longer operates as a charitable organization.’”). See also, INTERNAL REVENUE SERVICE, PUBLICATION 17, YOUR FEDERAL INCOME TAX, Civil Penalties (1995).

effective deterrents in dealing with this problem. More detailed discussion will follow below concerning possible legislative and enforcement options to deal with this serious issue.

Burden of Proof

A characteristic common to many of the cases in each class was the issue of burden of proof. Many cases came down to who was best able to bear the burden of proof regarding the purported illegal acts. An organization can appear to be involved in illegal activity but adequate records and testimony can rebut the government’s presumption as to failure of the statutory requirements. This issue required the analysis of individual cases for information about the extent of the problem and clues to possible responses. For instance, in Morey v. Riddell\textsuperscript{36} the taxpayer’s church was held exempt despite the lack of formal organizational documents, an accepted identifying name, a permanent headquarters and only limited records. What they did have were real and regular religious services, functions, tenets and a congregation and a state law that protected the assets upon dissolution.

In Boman v. Commissioner\textsuperscript{37} the organization was allowed exemption despite the leasing of foundation property to a partnership controlled by the founder. The transaction was proven to be arm’s length and thus, the organization retained its exemption.

\textsuperscript{36}62-2 USTC 9673.

\textsuperscript{37}57-1 USTC 9344.
In *Broadway Theatre League of Lynchburg, VA*\(^{38}\) the organization was held to be exempt despite overly broad organizational documents, and the existence of a contract with United Booking Artists to share in profits. The organization was able to prove that the contract was arm’s length, the amount of estimated income to be paid was reasonable compensation for services and that there was an existing industry standard for this type of arrangement in this form. This is even though United Booking had extremely broad powers under the contract essentially allowing them to take over the production and sales if the Theatre League failed.

In the case of the *W.B. Chase Foundation*\(^{39}\) the organization retained its exempt status despite substantial accumulations of income, and regardless of the fact it made grants to employees and family members of employees of related corporations. The burden of proving that the organization served broad charitable purposes was carried partly by showing that the scholarships were available to outsiders as well and that the employees who had received or were receiving scholarships had no obligation to remain with the company.

These cases are examples of ones in which substance overrode form. Substance is very often an adequate defense for tax disputes. These examples, however, did not involve fraud of the type described in the previous section. The burden of proof is generally upon the taxpayer’s shoulders unless fraud or tax evasion has been alleged. In those especially egregious cases where fraud is evident, the

\(^{38}\) 68-2 USTC 9658 (DC VA 1968).

\(^{39}\) 19 TCM 234 (1960).
burden belongs to the Commissioner of Internal Revenue.\textsuperscript{40} Review of these cases which make a special point of addressing the issue of burden of proof suggests that it may be possible to improve compliance and deter fraud through changes in the application of burden of proof requirements. For example, shifting the burden in fraud cases to the taxpayer might discourage founders from perpetrating a fraud if they know they might have to defend it in court. Additional discussion about burden of proof alternatives aimed at stemming abuse will follow.

**Organization and Application**

A large number of cases, particularly class B cases where illegal acts were absent, but exemption was forfeited nonetheless, were decided based upon their failure to meet the organizational test of the statute and/or a failure to meet the procedural standards to perfect that status. Some 86.2\% of all Class B cases dealt with either organizational or procedural issues. Although this may not be a particularly large number or high percentage of the total body of case law (about 5\%), it is significant that this class of cases was so heavily weighted toward this type of act. This issue was dismissed in large part by the literature as a nonissue yet, if the case law is any indication it is one that may require some new legislative or enforcement emphasis.

Recently the *Wall Street Journal*\textsuperscript{41} reported that the IRS approved a record 46,887 exemption applications last year. This is despite the fact that in 1986 the Tax

\textsuperscript{40}IRC Section 6902, Section 7454, and related regulations.

Code was changed to require an application fee between $150 and $500. At least one author has suggested that tax exemption has become easier to obtain which may add to the growing distrust of voluntary organizations and fuel the crisis. The case law suggests possible changes to the form of application, the process of application, the fee schedule, and the standards for exemption might have a profound effect upon these perceptions. More discussion of enforcement options related to organization and application issues is provided below.

**Multiple Issues—Complexity**

The tax law is viewed by many as exceptionally complex. Given the current perception of charities, it is likely additional regulatory complexity will ensue. This regulatory complexity may put the large number of smaller charitable organizations at a disadvantage when litigating tax issues. The analysis of the case law supports the conclusion that organizations are more likely to retain their exemption in single issue cases and the government is more likely to prevail in more complex cases with multiple issues.

Only about 28 percent of all the cases dealt with one type of illegal act or failure to act. A very high percentage (72.8%) of those cases were decided for the taxpayer or organization (Class C). A very low percentage (11.3%) of those cases

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42 See, Internal Revenue Service, Form 8718 - User Fee for Exempt Organization Determination Letter Request, (995) (this form and the applicable fee must be submitted with all exemption applications).

were decided against the taxpayer or organization (Class A). In addition, the number of cases finding for the organization and their percentage of the total has decreased significantly and steadily (from 44 percent to around 10 percent) over the last 40 years. As complexity increases, it appears that the government has an advantage. The more complex cases more often held for the government. These more complex cases increased steadily and substantially in number and percentage over the 40 year period (from 39.3 percent to 83.3 percent of all cases). This trend may put smaller organizations at a distinct disadvantage as they would be least likely to be able to afford topnotch legal counsel or any legal counsel. Whether intentional or unintentional, this trend suggests that it may to possible to regulate what cases come to trial perhaps further deterring aberrant behavior. For instance, although Tax Court rules prohibit lay persons from representing corporations before the court,44 new administrative procedures or settlement arrangements might be developed to allow for compromise in the less complex cases. This will be discussed further below.

**Founders, Family Members and Insiders Versus Outsiders**

As described in Chapter 4, founders and family members constituted by far the largest groups of perpetrators of illegal acts. Founders were involved in 90.2 percent of the instances of Type 1 private inurement acts and 92.2 percent of Type 2 exclusivity violations. Family members were involved in 48.2 percent of all Type 1 private inurement acts. Many of these violations involved the payment of personal expenses, the third highest number of all violation subtypes and by far the largest

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44 Abadian, Bahman K. v. Commissioner, 93 TNT 234-18.
percentage of Type 1 private inurement subtype cases where exemption was forfeited (44.2 percent).

This appears to be a perfect opportunity for new administrative procedures or regulations directed specifically at founders and family members. For instance, changes in exemption requirements or application procedures could make it more difficult for these persons to exert the kind of control necessary to cause these illegal acts to occur.

In the past there has also been great concern about outsiders exerting undue influence over the income or assets of these organizations. However, from the analysis of the case law, this does not appear to be a major problem. Unrelated persons only accounted for 1.8 percent of Type 1 private inurement instances and 2.34 percent of Type 2 exclusivity violations. Thus, despite the Service’s insistence and written intent to expand the category of persons who might have received a prohibited benefit,\textsuperscript{45} there appears to be little need. The Service needs to focus its efforts on those areas where there has been proven to be substantial and recurring compliance problems, not on areas where there might be a problem or where the problem is at worst, intermittent.

**Commercial Activities**

The issue of the size and extent of commercial or unrelated activities was also shown to be important. This violation subtype (type 2(e)) was found more often than

\textsuperscript{45}See G.C.M. 39498; G.C.M. 38905; and G.C.M. 39670.
any other constituting 17.3 percent of all violation subtypes and nearly 40 percent of all Type 2 exclusivity violations. However, even more significantly this subtype accounted for 92.7 percent of all Type 2 exclusivity subtypes for Class C cases where illegal acts were found to be absent and exemption was retained. This statistic suggests two things: 1) any organization involved in a dispute with the Service over this issue may wish to pursue litigation since the organization is often successful in these cases, and; 2) the present statutory scheme designed to control and tax unrelated activities and the related definitions are insufficient to achieve appropriate controls. Additional legislation, regulations or administrative procedures may be called for in order to effectively stem this illegal activity. Legislative and enforcement options are discussed in more detail below.

Dealing With Common Characteristics

Introduction

One of the stated goals of this analysis was to take what we learned about the case law and use that information to suggest possible responses to the perceived legal and ethical crisis. This section of the analysis undertakes to do just that. Discussion of each of the common problem areas identified in the case law follows along with possible legislative, enforcement or practice responses suggested by the case law and the patterns therein.
Churches and Tax Evasion

Introduction. The research clearly indicated the use of churches or so-called churches to evade federal income taxes to be a major enforcement and/or policy problem. In the past the mere declaration that an organization was a church was very often sufficient to secure its treatment as such under the tax laws. As mentioned above, the law does not require churches to apply for tax exempt status, but they may do so in order to secure the ability to provide advance assurance to their donors as to the deductibility of their contributions. Abuse of the tax laws for personal gain, although nothing new, however constantly gets ever more creative. This abuse began in earnest with the Universal Life Church\(^{46}\) in the late 1960s and early 1970s who aggressively promoted “mail order” churches and ministries. Although the Service litigated many of these cases, there were probably as many or more of these organizations that escaped scrutiny.

This lack of coherent and consistent policy and enforcement led to the proliferation of imitators such as the Church of Scientology,\(^{47}\) the Basic Bible Church,\(^{48}\) the Church of World Peace,\(^{49}\) The Church of Ethereal Joy,\(^{50}\) Freedom

\(^{46}\) 72-1 USTC 9467, 74-1 USTC 9345, 76-2 USTC 9548 (DC 1976), 86-1 USTC 9271, 87-2 USTC 9617, 88-2 USTC 9485, 89-1 USTC 9152 (1989).


\(^{48}\) 74 TC 846 (1980).

\(^{49}\) TCM 94-87, 94 TNT 40-28 (1994).

\(^{50}\) 83 TC 20 (1984).
Church of Revelation, and The Bubbling Well Church of Universal Love. These organizations and their affiliated “churches” promoted tax avoidance schemes in newspaper and magazine ads and public seminars touting income tax savings of 70 percent or more. Tax savings and profit motivated these ads not religious beliefs. The promoters charged new “ministers” a fee to “ordain” them and show them how to set up their own church for the purpose of evading income taxes.

Defining a Church. Neither the Code nor Regulations define the term “church” in any detail. It appears from the Congressional record and the interpretation of that record by the courts that Congress intended the term have a more restrictive meaning than “religious organization.” The courts have intimated in some instances that due to the lack of specific guidance by the Congress and the absence of “a meaningful regulatory definition,” the term should be interpreted “in light of the generally accepted meaning and usage of the word.”

The definition must be more concrete, however, if the Service is to have any hope of enforcing it and applying the related benefits. An organization’s stated beliefs are an insufficient criteria for defining it as a church for tax purposes. Although all

84-1 USTC 9485 (DC-DC 1984).

74 TC 531 (1980), aff’d 82-1 USTC 9258 (CA-9 1981).


churches may be religious organizations, not all religious organizations are churches. The law requires an application for exemption for religious organizations just as with any other charitable organization. Thus, considering the means by which an organization accomplishes its religious purpose is essential when evaluating its status as a church. The courts have consistently adopted the view that a significant part of the activities of the organization be associational. That is, "the word 'church' implies that an otherwise qualified organization bring people together as the principal means of accomplishing its purpose." The courts have stated this to be the minimum requirement for qualification as a church. "At a minimum, a church includes a body of believers or communicants that assembles regularly in order to worship."

Although lacking the authority of legislation or regulations, the Service has attempted to define what other criteria must be present in order to qualify an organization as a church. They are:

1) a distinct legal existence;
2) a recognized creed and form of worship;
3) a definite and distinct ecclesiastical government;
4) a formal code of doctrine and discipline;
5) a distinct religious history;
6) a membership not associated with any other church or denomination;
7) an organization of ordained ministers;

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56 Foundation for Human Understanding, supra note 54.
57 IRC Section 508(c) and Treas. Reg. Section 1.508-1 (a)(2).
58 Chapman v. Commissioner, 48 TC 358.
59 Id.
8) ordained ministers selected after completing prescribed studies;
9) a literature of its own;
10) established places of worship;
11) regular congregations;
12) regular religious services;
13) "Sunday" schools for religious instruction of the young; and
14) schools for the preparation of its ministers. 61

In addition, the Service has announced it will consider any other facts and circumstances that bear upon whether or not an organization claiming to be a church in fact operated as a church. 62 Several courts have endowed these criteria with the force of law by expressly adopting them in their decisions on these issues despite the unlikelihood of any traditional church meeting all the criteria. 63 One court indicated of primary importance are numbers 4, 7, 11, 12 and 13. 64 Still others have narrowed the list even more concentrating almost entirely on the associational aspect evident in criteria 11 and 12. 65 This lack of consistent application of admittedly self-serving governmental criteria by the courts makes for conflicting conclusions in litigating these issues. 66

61 This list has been incorporated into the INTERNAL REVENUE MANUAL at IRM 7(10)69, and IRM 321.3(3) (Apr. 5, 1982).

62 IRM, supra, 7751, 321.

63 See e.g., Lutheran Social Services, 84-1 USTC 9383, rev'd and rem'd 85-1 USTC 9316 (CA-8 1985); American Guidance Foundation, 80-1 USTC 9452 (DC 1980), aff'd in unpublished opinion (CA-DC 1981); and Williams Home, 82-2 USTC 9447.

64 American Guidance Foundation, supra note 63.

65 Church of Eternal Life and Liberty, 86 TC 916 (1986).

66 But cf., Foundation for Human Understanding, supra note 54 (which held for the organization despite the lack of any set structure or liturgy in its religious services,
Discussion. Although further regulation of churches may be generally undesirable and frightening due to the possible encroachment on constitutionally guaranteed religious freedoms, some of these issues might be effectively dealt with without significant affect on those freedoms. The Supreme Court has held that there should be a balance between the interests of the government and those of the individual: "First, plaintiff must show a burden on the exercise of his religion by the law under review. Second, the burden will be upheld only if the government interest outweighs the degree of impairment of free exercise rights . . . ."

When evaluating the appropriate level of oversight between government and churches the focus is generally on the establishment and free exercise clauses of the First Amendment. Unfortunately, "... little agreement exists on the meaning of those words, especially the establishment clause." However, recent research into the founder's design or intent seems to indicate that regulation of churches is permitted if, in the bigger picture, it promotes the separation of church and state. While the goal of avoiding excessive governmental entanglement in religion might drive much of the regulation of religious organizations, or the lack thereof, it does not prevent or prohibit legitimate taxation or oversight. For instance, virtually every state allows for the taxation of property owned by religious organizations used for or dedicated to separate physical facilities, religious instruction for the young, and a school for the preparation of its ministers); contra, Bubbling Well Church of Universal Love, supra note 52 (which forfeited its exemption for lacking many of the same criteria).

67 U.S. v. Holmes, 614 F.2d 985 (5th Cir. 1980).


69 Id.
non-exempt purposes.\textsuperscript{70} The courts have held the government's interests in maintaining the integrity of federal tax policies to be sufficiently compelling to allow any incidental infringement on First Amendment rights.\textsuperscript{71} Many religious organizations themselves recognize the rights of government and their own obligation to obey government:

There are biblical limits on how and when believers can disobey government. First, disobedience is not allowed simply because the government limits religious freedom. Rather, government must negate freedom. All laws limit freedom. It is the nature of law to draw lines so that one may know where his freedom ends and another person's begins. Thus, government regulations regarding zoning, parking, and safety are not in themselves oppressive and should be obeyed, even though they limit the freedom a church has . . . . That is, the government must eliminate religious freedom, not simply regulate it, before a believer should disobey the government. Second . . . noncompliance to oppressive laws should . . . not be a revolt . . . . To contemporize the principle, Christians should refuse to kill a human life . . . even if the government commands it. But they should not revolt against a government nor withhold taxes from the government because it commands it.\textsuperscript{72}

\textsuperscript{70} \textsc{Fachina, Bazil, Showell, Evan, and Stone, Jan E.}, \textit{Privileges \& Exemptions Enjoyed by Nonprofit Organizations: A Catalog and Some Thoughts on Nonprofit Policymaking}, 47 (N.Y.U. School of Law 1993).


\textsuperscript{72} \textsc{Living Ethically in the '90s}, 162-63 (Anderson, J. Kerby, ed., 1990). \textit{See also}, Jeavons, Thomas, \textit{Stewardship Revisited: Secular and Sacred Views of Governance and Management}, 23 \textit{Nonprofit and Voluntary Sector Quarterly} 107, 122 (Summer, 1994).
Thus, it should be possible to adopt a legislative and/or regulatory scheme aimed at this abuse without great disruption to these First Amendment rights. An exemption requirement that included some or all of the 14 criteria enumerated by the IRS and adopted by some of the decisions in the case list might go a long way toward uniformity of definition. It could help to eliminate some of the inconsistency in application of these criteria by the courts.

Burden of Proof

Introduction. Review of the findings in Chapter 4 indicate it may be possible to positively affect compliance through the tightening of the burden of proof requirements of the statute.\(^\text{73}\) In general, the law requires:

The taxpayer shall have the burden of proof . . . except as to the issue of whether the taxpayer has been guilty of fraud with intent to evade tax.\(^\text{74}\)

In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of proof in respect of such issue shall be upon the Secretary.\(^\text{75}\)

It appears from the legislative history for these sections that there was some fear over the possible abuse of power if the burden of proof was solely the taxpayer’s

\(^{73}\text{IRC Sections 534, 6902, 7422 and 7454 and related regulations.}\)

\(^{74}\text{IRC Section 7422(e).}\)

\(^{75}\text{IRC Section 7454(a) (The reference to Secretary is to the Secretary of the Treasury).}\)
in all cases. There is no evidence of such abuse in this century. There is empirical evidence that nonprofits prosper in states where regulation of their activities is more stringent.\textsuperscript{76}

This burden of proof standard is applied to each issue in a case. For instance, in \textit{Freedom Church of the Revelation}\textsuperscript{77} this standard is applied separately to the exclusivity issue of promotion of tax avoidance schemes for profit and to the issue of inurement to its founders. In this case, however, fraud was not at issue despite the fact that the church was actively promoting tax avoidance through seminars representing 70 to 100 percent tax savings from formation of affiliated churches. Regardless, the organization failed to "provide any financial records to buttress its claims that it is organized primarily for exempt purposes."

\textbf{Discussion.} These standards are extremely broad. The courts have often given the Service broad discretion over what information they may seek in making a determination.\textsuperscript{78} Other times the courts have been quite lenient toward the organization in meeting this standard.\textsuperscript{79} This makes for inconsistent rulings similar to the church/sham situation above.


\textsuperscript{77}supra note 51.

\textsuperscript{78}See e.g., Church of Gospel Ministry, 84-1 USTC 9497 (USDC 1986).

\textsuperscript{79}Bethel Conservative Mennonite Church, 84-2 USTC 9870 (7th Cir. 1984), rev'g 80 TC 352 (1983).
Thus, the case law suggests incorporation of more specific burden of proof standards into the Code or regulations might positively affect compliance and result in more consistent findings by the courts. For example, requiring membership organizations to provide a list of their members as one specific requirement of the burden of proof statute could discourage those sham organizations from attempting an evasion of taxes. Shifting the burden in fraud cases to the taxpayer might also have a positive impact upon compliance since perpetrators of frauds would know they might have to defend those positions in a court of law. Application of the due process requirement of the Constitution can effectively address the issue of abuse of power eliminating that concern.

Organization and Application

Introduction. Despite the fact that the application for exemption for charitable organizations has grown to 29 pages and the law now requires an application fee, record numbers of applications are being submitted and approved.\(^{80}\) The Form 1023 and instructions are attached as Appendix C. Obviously, it is a lengthy and complicated form requiring numerous attachments and representations. The impression exists, however, that skillful preparation by a tax lawyer or CPA can lead to the granting of exemption to organizations who, because of their business or other activities, have no business possessing exemption.\(^{81}\)

\(^{80}\) 46,887 last year according to: *Tax Report, supra* note 41, at A1.

\(^{81}\) Emshwiller, *supra* note 2.
In relation to the issue of organization and application, the case law indicates some organizations are misrepresenting their activities or changing their purpose, character or method of operation after being granted exemption, but without first obtaining the Service's approval for that change. The problems with the process and approval of exemption applications goes beyond the issue of commercial activities, but this is a significant part of the mix and current debate. As indicated above one of the most frequent types of violations in the case law was the commercial or unrelated activity.

Discussion. The form of the application for exemption and the annual information return for nonprofits puts a great deal of emphasis on organizational form and on finances and very little emphasis on service efforts and accomplishments. The accounting profession has been debating the reporting of service efforts and accomplishments in addition to financial data for more than 15 years. Yet, no such requirement has been adopted to date; not for financial accounting purposes and not for annual tax reporting.

There is also a great deal of speculation involved in completing the application for exemption. That is, because these are most often newly created organizations,

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82 See e.g., Abadian, Bahman K., supra note 44, or American Science Foundation, 52 TCM 1049 (1986).


nonprofit directors must speculate about what their organization might accomplish, what its goals are and how it intends to effectuate those goals. Yet, after granting exemption based on what are often clearly pie-in-the-sky financial and service goals, there is little or no follow-up by the Service as to the partial or complete realization of these goals or even whether the organization undertook those purported activities. The tax law allows the Service to issue an advance ruling then to follow-up at a later date with a final determination. This final determination, however, is most often limited to merely looking at financial resources to judge the level of public support of an organization and generally does not involve any consideration of an organization’s goals or service accomplishments.

The case law suggests improvements to the process of organization and application for exemption might be possible if the Service were to put more emphasis on the “public goods” issue. Specifically considering what goods or services an organization intends to offer, how those services differ from those offered elsewhere, and whether the organization did what it said it would do might improve compliance. Considering what constituency might be served that is not presently being served and why that constituency needs that service might help to weed out illegitimate organizations. Generally, these mechanisms are already in place, it’s just a matter of a change in emphasis.

In addition, it might be possible to achieve improvements to the process if the law did not permit newly formed organizations to attain exemption. “The entire tax scenario that has been written for new organizations, in fact is a wasteful process which causes many organizations to incorporate and seek tax exemption before
demonstrating viability as an organization." The rules already permit exemption to be retroactive to the date of formation if an organization files Form 1023 within its first 15 months of existence. Requiring organizations to first operate for a full 12 months before granting exemption might eliminate much of the speculation about their activities. Real information about their purpose, character and method of operation would then be available to evaluate their qualification for exemption.

Complexity

Introduction. Numerous authors have suggested that due to changing economic and social conditions in both the governmental and nonprofit sectors, there have been increasing amounts of and complexity in regulation of nonprofits. The size and economic importance of the nonprofit sector has grown "at a significantly increased rate" which has also contributed to complexity.

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86 See Internal Revenue Service, Instructions for Form 1023, supra note 35, at 3 (attached Appendix C).


The climate is such that increased regulation is a forgone conclusion. Article after article has appeared calling for increased oversight over nonprofits. Assuming that government has a legitimate role when it comes to regulation of charities, then it is likely more complexity will ensue in the future rather than less. Thus, charities might wish to develop strategies to deal effectively with increasing regulatory complexity and the courts' propensity to find against organizations in complex exemption cases.

Discussion. It is impossible to anticipate every regulatory or ethical standard that might be applicable to charitable organizations. Numerous regulatory issues beyond the scope of this analysis are under consideration in numerous jurisdictions, including postal rates\textsuperscript{90}, lobbying limits\textsuperscript{91}, solicitation rules\textsuperscript{92}, compensation and benefits rules\textsuperscript{93}, reporting requirements\textsuperscript{94}, accounting and disclosure rules\textsuperscript{95}, and many, many more.

\textsuperscript{89}See e.g., Kimelman, John, Too Charitable to Charities?, FINANCIAL WORLD MAGAZINE, September 1994, at 1; Williams, Grant, End of New Era Sparks Renewed Debate Over The State of Charity Regulation, CHRONICLE OF PHILANTHROPY, June 1, 1995, at 30; and Power, William, Philadelphia Wonders How It Got Fooled By New Era—and What Lies Ahead, WALL ST. J., May 18, 1995, at B-1.


\textsuperscript{92}Goss, Kristin and Williams, Grant, Deceptive Telephone Appeals for Charity Called No. 1 Problem for State Regulators, THE CHRONICLE OF PHILANTHROPY, November 30, 1993, at 27. See also, Suhrke, Henry, Telemarketing Regulations, PHILANTHROPY MONTHLY, August 1994, at 4.

\textsuperscript{93}Suhrke, Henry, Final Regulations: Family and Medical Leave Act, PHILANTHROPY MONTHLY, August 1994, at 25.
many others.96 Herein, the research and analysis of the case law indicated it is the more complex tax cases which are being litigated and the government is more often successful in these cases than the organization. Thus, organizations may wish to develop strategies to avoid putting themselves in those positions. Discussion in the nonprofit literature has centered around self-policing, self-regulation, required continuing education or ethics testing. The lack of one agency to oversee these activities, however, makes it incumbent upon all organizations to get their own house in order. At least two authors have suggested the appointment of one agency at the federal level to act as policeman, coordinator, and advocate for the sector specifically citing the Securities Exchange Commission as a model.97 The addition of another bureaucracy should probably be discouraged given budgetary and other concerns. Review of the literature on nonprofits suggests that organizations may wish to consider the following:


96 See, FACHINA, SHOWELL AND STONE, supra note 70, at 55, 66 (For example, antitrust rules and securities regulations are being expanded to encompass nonprofits' activities).

Training—Most charitable organizations have staffs or volunteers with specific interests or skills in the primary activity of that organization. Thus, artists run arts oriented entities; musicians run music oriented entities; doctors and other health professionals often run hospitals, clinics and hospices; counselors and psychologists run mental health facilities and substance abuse treatment facilities; fund-raisers run affiliated foundations and community foundations; and volunteers with no specific training run tens of thousands of small grassroots organizations. What this means is that most persons running these organizations have no knowledge or understanding of the tax or other legal requirements imposed on these organizations or any other formal training in nonprofit management or governance. Thus, training may be extremely important to the continued vitality of the charitable sector.

Professional help—One case involved an organization that did community rehabilitation of convicted felons. The organization had been in existence for 5 years yet had never filed any payroll tax returns, an annual information return (Form 990) or an application for exemption. And every member of the board was an attorney or a judge! But they were all criminal attorneys or former prosecutors and knew little about the tax law. Substantial fees and penalties were incurred to straighten out the problem because the

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organization waited to obtain real professional help until after a problem developed with the IRS.

Compromise/change—Generally, a good way to avoid litigation is to be willing to compromise on the issue at hand or change the organization’s purpose, character or method of operation to fit more accepted definitions. The research suggests organizations can prevail on these issues as evidenced by the large number of Class C cases. Organizations should thus, choose their battles carefully.

Avoid trouble—Charitable organizations have historically occupied a spot at the “intersection between individual and group ethics.” Ethics continue to be an important part of charity. However, the research indicates bad things can happen to good organizations when one of these three things occur: “the presence of people drawn to the sector by nonaltruistic motives; the acquiescence of deluded altruists to self-serving temptations, and the presumption . . . that unethical means may be justified by altruistic ends.”

Persons with these inclinations or beliefs have no place in legitimate charitable

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99 O’Neill, Michael, *Ethical Dimensions of Nonprofit Administration*, 3 NONPROFIT MANAGEMENT AND LEADERSHIP 199, 213 (Winter, 1992) (“The study of nonprofits offers an opportunity to discuss ethical issues across a wide front on two basic levels, the personal and the systemic.”). *See also*, Atkinson, Rob, *Major Legal Topics to be Covered in a Law School Course on Nonprofit Organizations*, in *RESEARCH AGENDA: LEGAL ISSUES*, supra, at 25.

endeavors and presumably all charitable organizations would work together to weed them out.\textsuperscript{101}

**Founders, Family Members and Outsiders**

**Introduction.** One of the primary features of the 1969 Reform Act was the series of excise tax provisions aimed at private foundations. The purpose of these rules was to severely limit the activities of private charitable foundations and severely penalize them for acts outside very strict limits. Prior to 1969, the Service's sole remedy was to revoke the organization's exempt status which the Service is often averse to particularly for minor grievances. Such a severe penalty did little to punish the foundation manager who often caused the violation in the first place. The “intermediate sanctions” presently under consideration by the Congress adapts many of these prohibitions and penalties for private foundations to cover public charities. These sanctions, which are discussed in more detail below, are aimed primarily at founders, family members, directors, officers, trustees and other insiders who unduly benefit from the income or assets of the organization in situations similar to the ones documented in the case law.

**Discussion.** The hope is that the legislature will proceed cautiously before imposing highly restrictive regulations upon the hundreds of thousands of well-

meaning and well-run charities in order to control the few who are none of these things. "The last thing we need is thousands of law-abiding, responsible charities being asked to incur more regulatory costs that may have little or nothing to do with what they do or don’t do." 102

Hopefully, all organizations and the people who run them can learn from these recent failures and examine themselves for symptoms of corruption or policies which might make it easy to perpetrate. In fact, the negative publicity the sector has received lately may have been beneficial by encouraging nonprofit managers and trustees to work internally on solutions to potential problems. 103 At least one author, however, feels that charities have not taken sufficient steps in response to these scandals to deal with these issues and institute some self evaluation, self control and self policing. 104 As a result, the expectation is for some form of legal sanctions aimed at various uncharitable acts. 105

102 Williams, supra note 89, at 30 (attributed to Robert S. Tigner, general counsel of the National Federation of Nonprofits).

103 Schaffer, Scott, Public Scrutiny: An Opportunity for Nonprofit Reform, NONPROFIT TIMES, March 1994, at 9 ("There are a number of questions nonprofits must ask of themselves to move the sector in a positive direction:
- How does an organization measure effectiveness and success;
- What are the major staffing needs . . . ;
- What are the strengths and weaknesses of present information systems and what are the plans for improvement;
- How does the organization motivate employees and encourage productivity;
- How are customer needs assessed and incorporated into operations;
- How are finances managed and what safeguards are built into the process?")

104 Eisenberg, supra note 2, at 1214.

105 Carson, Marlis and Streckfus, Paul, EO Lawyers Get an Earful From the Government, 9 EXEMPT ORGANIZATION TAX REVIEW 1231 (June 1994) ("There has
Both the Treasury department and the President have proposed stiff new regulations aimed at “excess benefit” transactions with insiders. These proposals are substantially alike, in general calling for an initial tax of 25 percent and a second tier tax of 200 percent of any excess benefit to be imposed on the recipient. These “intermediate sanctions” have some appeal, but they also have much that is wrong with them. More discussion will follow on this issue later.

What is needed are more positive or preventative measures against these uncharitable acts by founders, family members and others. For instance, rather than fining organizations and their insiders after the fact, it might be more effective to set standards up front which might help to prevent these acts from ever taking place such as, taking the founder and their family members out of positions of control. This would have a real impact on their ability to perpetrate malfeasance.

These new sanctions may not be the panacea on these issues many are searching for. The use of fines or excise taxes should be limited to only the most egregious instances and directed at anyone, insider or outsider, who conspires to rob an organization of its resources. Although the problem of outsiders is nearly nonexistent as evidenced by the research in Chapter 4, limiting intermediate sanctions

been a shift from not if Congress will enact intermediate sanctions, but when and how.”).

to insiders may leave a window of opportunity open. In addition, organizations can expect the Service to be more aggressive about imposing the ultimate sanction; that is, the revocation of exempt status.

Commercial Activities

Introduction. The issue of commerciality is one of the most basic theoretical aspects in the debate over the rationale for exemption. Chapter 2 already covered this in some detail. It’s unlikely in any case, that the larger public policy issue can be resolved at this point. However, because of the high incidence of commercial activities in exemption cases (17.3 percent of all violation subtypes and nearly 40 percent of all Type 2, exclusivity violations involved commercial purposes) some new policy or enforcement strategies are needed to deal with these acts.

By a closer examination of some of the Type 2 exclusivity cases it may be possible to identify more specifically what the courts felt was the key to the decision reached. For example in Consumer Credit Counseling Service of Ala., Inc., a case which held for the organization, the commercial activity constituted an “integral part” of the agencies exempt function and therefore, did not require forfeiture of exemption. In Club Gaona, Inc., the primary activity was a commercial one, with substantial profits realized and accumulated. The activity was not an integral part of any charitable program causing the organization to lose its exemption. While there is no

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107 78-2 USTC 9660 (DC 1978).
prohibition against the realization of a profit *per se*, it is indicative of nonexempt purposes.

In *Christian Stewardship Assistance*,\(^{109}\) the nature and extent of the commercial activity cost the organization its exemption. That is, the nature of the activity was exactly the same as a for-profit financial planning business and the activity was substantial in size and scope. Perhaps if the organization had served some disenfranchised population these arguments could have been rebutted. They did not and so exemption was forfeited. In almost all these cases, the commercial activity was more than insubstantial which requires, under the regulations, denial of tax exempt status.\(^{110}\) This requirement was evident also in *Christian Manner International*,\(^{111}\) where the founder’s books, although religiously inspired, were marketed in a commercial manner for the primary purpose of making a profit. Thus, the exempt purpose existed (i.e. advancement of religious views), but in this case it was incidental to the larger commercial purpose.

In another case decided for the organization, *Boy’s, Inc. of America*,\(^{112}\) exemption was upheld even though commercial activities contributed the majority of the organization’s revenue. However, the organization had a real charitable program, there was no unrelated business income derived from the commercial activities, and no unreasonable accumulations. Contrast this case with *American Institute for Economic

\(^{109}\)70 TC 1037 (1978).

\(^{110}\)Treas. Reg. Section 1.501(c)(3)-1(c)(1).

\(^{111}\)71 TC 661 (1979).

\(^{112}\)66-2 USTC 9533 (DC-TX 1966).
Research where no real charitable purpose existed. The commercial activity was indistinguishable from similar commercial enterprises and profits were accumulated.

Unfortunately there is no simple or distinct pattern here from which to develop a new standard. Neither the courts nor Congress have required charitable organizations to abandon all commercial ventures, but continue to allow activities “... that bare no relation at all to the tax exempt purposes of an organization.”114 What the legislative history indicates is the desire to strike a balance between encouraging “... benevolent enterprise and restraining unfair competition.”115 Congress expressed this view again in 1969 when debating the 1969 Reform Act: “Your Committee believes that a business competing with taxpaying organizations should not be granted an unfair competitive advantage by operating tax free unless the business contributes importantly to the exempt function”116 (emphasis added). Interestingly, at least one author would argue that there is no competitive advantage.117 These issues are really beyond the scope of this analysis and so will not be debated herein. The primary issue found to be present in the exemption cases is the manner in which the organization

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116HOUSE REPORT NO. 91-413, part 1, at 50 (1969).

117Rose-Ackerman, Susan, Unfair Competition and Corporate Income Taxation, in Gies, Ott and Shafritz, supra note 100, at 91.
conducts the commercial activity.\textsuperscript{118} This is supported by the regulations\textsuperscript{119} When conducted in an exploitative, commercial business like manner the activity was almost invariably found to be outside the scope of the organization’s exemption. The general public is generally not concerned so much with the manner (the means), but more so with the ends. That is, when two organizations, one exempt and one not exempt, offer similar services “... consumers prefer nonprofits because that is the only way to be sure that contributions advance the stated goals of the organization rather than just increasing the profits of entrepreneurs.”\textsuperscript{120} The law, however, cannot allow just any means to be justified by the ends.\textsuperscript{121}

Congress has had plenty of opportunity to tighten these rules and has chosen not to do so, but rather has chosen to rely on the balanced approach described briefly above.\textsuperscript{122} While this allows for maximum flexibility for the charitable organization, it leaves unanswered questions, gray areas in the law, and rules that are open to varying interpretations. Organizations need to have a clearer understanding of what is acceptable behavior and what is not.


\textsuperscript{119}Treas. Reg. Section 1.513-1(d)(4)(iv).

\textsuperscript{120}Krashinsky, Michael, \textit{Transactions Costs and a Theory of the Nonprofit Organization}, in \textit{ECONOMICS OF NONPROFITS, supra}.

\textsuperscript{121}See C.F. Mueller Co. v. Comm., 190 F.2d 120 (1951).

\textsuperscript{122}See Chapter 2 for a discussion of some of the Committee discussions and their reluctance to make fundamental changes to the substantially related test of the statute. \textit{See also}, Jones, P., \textit{Treasury Advocates UBIT Fine Tuning; But UBIT Overhaul Not Needed}, TAX NOTES, May 16, 1988, at 791-793.
Discussion. There are two standards derived from unrelated business income cases described in Chapter 2, which if codified into the exemption statute, might go along way toward eliminating many of the exemption disputes over commercial activity. The first, in Carolinas Farm Power,\(^{123}\) dealt with the issue of "substantially related":

- whether fees charged for the goods or services provided are directly proportionate to the value of the goods or services received;

- whether sales or participation is limited to a particular class of individuals and thus, is of no benefit to persons outside that class; and

- whether the goods or services provided are ones commonly available from or furnished by forprofit entities.

The first gets at the motivation for a fee; that is, is it to recoup the costs of providing the service or is it designed to produce a profit? Further, if the fee schedule is such that a profit is produced, is it reasonable in relation to the continuing needs of the public for the service provided or is its intent to accumulate large surpluses for any purpose related or unrelated? A reasonable fee should result in a finding of a noncommercial purpose.

The second standard gets at to whom the service is directed; that is, are services limited to members only or alternatively, are they available to the general public?

\(^{123}\)83-1 USTC 9161 (CA-4 1983).
public? Or, is there some charitable class such as the aged or poor who are being under-served by business or government that this organization’s services are directed at? Generally, making services available to a charitable class of persons or making services available to the general public in a more efficient manner or at a lower cost, should result in a finding of a noncommercial purpose.

The third test is the most important. It gets at whether the purpose of providing the service is an exempt purpose; that is, is it essential to the accomplishment of a charitable purpose? If it is not essential, is the activity incidental to other essential charitable activities? If these questions can be answered in the affirmative, it may be irrelevant that the activity is highly commercialized and in competition with forprofit business.

It's difficult to say whether adding these requirements would improve the exemption statute. Although they may be somewhat more objective than the present causal relationship standard described in Chapter 2, there may still be room for interpretation. Another possible substitute test may be the three part test described in Chapter 2 which is used in connection with piecemeal evaluations of museum gift shop revenues. This test focuses upon the nature, scope and motivation for each activity to determine whether it contributes importantly to an exempt purpose. For instance, asking whether the activity is conducted in a highly commercialized manner and whether it is in competition with for-profit business gets to the nature of the activity. Does it appear to be like similar for-profit businesses in how it operates?

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124 PLR 8313013.
Asking whether the activity is conducted in such a manner so as to be beyond the reasonable needs of the charitable enterprise gets to the scope of the activity. Is the activity conducted over a substantial period of the year or available season; are the goods and services offered similar to those offered by for-profit businesses? These and other questions can assist in evaluating the scope of an activity. And asking whether the primary intent of the activity is to produce income or to produce and distribute public goods or services without regard to profit gets to the motivation. These three criteria could assist in evaluating activities for a commercial hue by helping to determine the true character of any given activity. Such an evaluation should include determining whether the organization could achieve its exempt purpose without the particular activity. Adding these tests to the existing exemption requirements might provide more objective standards for exemption resulting in fewer exemption cases where commercial activities are an issue.

Other General Discussion

Introduction

To date almost all nonprofit organization law has been based on anecdotal data, much of which is related to larger organizations . . . What we do not know and cannot assume is the extent to which medium and small sized organizations are served by the laws which presently exist and nature of their unfulfilled requirements.125

While this is an agreeable statement, there may still be legislative or enforcement options which can assist in positively affecting the behavior of all charitable organizations, regardless of size or primary purpose. Although many of these recommendations may be beyond the scope of the research findings, it might be no less valuable to enumerate them here in order to begin the debate about their necessity, applicability or appropriateness. Some of the suggestions above such as more concrete and specific exemption requirements; requiring a period of existence as a precondition for exemption; control restrictions for founders and family members; better follow-up by the Service on representations made in exemption applications; and better enforcement of the unrelated business income rules; all could have a positive affect on enforcement efforts relative to exemption.

In addition, consideration might be given to requiring new organizations to post a bond to cover any prospective tax liability or penalties they might owe should they fail to qualify for exemption; engage in unrelated business activities; or attempt to perpetrate a fraud. After an appropriate period of operation within the rules, the bond could be released. Such a requirement, while perhaps a financial hardship for many new organizations, would do little to discourage truly sincere, well-meaning and necessary efforts from getting off the ground. Alternatively, the exemption could be made to cover a period of years rather than being for the life of the organization. Requiring an organization to reapply every 10 years or so would give the Service substantial information necessary for enforcement about the purpose, character and method of operation of these organizations.

One commentator has suggested creating a new form of corporation for small organizations which would allow those small organizations to operate on a more
informal basis than existing corporate structures allow under state law.\textsuperscript{126} This new “close corporation” would be more like an incorporated partnership with an integration of directors and employees and an upper level of permitted assets.\textsuperscript{127} It was suggested this new form of simplified nonprofit organization might allow for more flexibility in responding to community needs. However, the disturbing part of this idea is that the author suggests these organizations could operate “without direct attorney general supervision, but would still be able to obtain tax exempt status.”\textsuperscript{128} This might open the door to more horror stories.

Finally, consideration needs to be given to modifying, at least in part, the rules governing the liability of charities to their donors. This is a difficult position. Some would say that suing a charitable organization is a courageous act aimed at stemming corruption or mismanagement that would otherwise go unnoticed and unpunished. Others might see it as a despicable act, adding to the increasing cost of the charity’s services, adversely affecting its ability to provide those services, and to attract contributions and people willing to serve on its board.

Because of the ‘fragile nature’ of charity, it must be run well to retain public confidence. Public confidence arises in part by holding managers, directors, and officers of nonprofits responsible for their conduct, but it also arises by clearly defining the role of these


\textsuperscript{127}\textit{Id.} at 667.

\textsuperscript{128}Moody, in \textit{RESEARCH AGENDA: LEGAL ISSUES}, \textit{supra} note 85, at 31.
individuals and the standards to which they are held, and by providing channels for all interested parties to challenge uncontrolled activities.\textsuperscript{129}

Perhaps there are ways other than allowing suits by donors to improve the accountability of officers, directors and trustees, such as statutory sanctions against certain actions.\textsuperscript{130} This is part of the debate over "intermediate sanctions."\textsuperscript{131} But if these provisions are delayed another two years, donors and others at interest might want to know what other courses of action are available.

A return to the historical context of charitable entities as a public trust (in the legal sense only with regard to standing to sue) might obviate the need for further legal reform. Other suggestions in the literature include: 1) increasing the rights of inspection of organizations' records by the general public;\textsuperscript{132} 2) permitting "derivative

\textsuperscript{129}Balda, Janis Bragan, \textit{The Liability of Nonprofits to Donors}, 5 \textsc{Nonprofit Management and Leadership} 68, (Fall 1994) (footnote omitted).

\textsuperscript{130}McIlney, Dennis P., \textit{The Public Accountability of Foundations: Private Organizations in the Public Interest}, \textsc{Philanthropy Matters}, 17 (Indiana University Center on Philanthropy, Spring 1994) (another suggestion involves having state and local governments who register charities or receive a copy of their annual report or information return produce a directory of nonprofit organizations available to the general public).


\textsuperscript{132}For most charitable organizations the only right the public has regarding inspection is the right to view a copy of the organization's annual information return (\textsc{Form 990}–see \textsc{Instructions, supra}). In some states an annual report is filed with the state attorney general which is open to public inspection (e.g. Arizona).
actions" in limited situations;\textsuperscript{133} or, 3) expanding the circumstances whereby controlling individuals are held personally liable for corporate actions.\textsuperscript{134}

Generalizations

Noncharitable Nonprofits

Introduction. Although charitable organizations were the primary focus of this study, they are not the only ones perceived to possess significant behavior problems. Nor are they the only ones being studied for possible remedial action. A recent Government Accounting Office (GAO) report to Congress identified some potential areas of concern:

Press reports and congressional hearings have recently focused on the activities of charitable organizations, but other types of tax exempt organizations have not received this level of scrutiny. As you requested, we (1) determined the growth in the number, assets revenue, and expenses of social welfare organizations, labor and agricultural organizations, and business leagues, (2) documented the compensation that some of the largest of these tax exempt organizations paid their executives in 1992, (3) identified the extent to which these

\textsuperscript{133} A derivative action is a suit against directors resulting from a breach of fiduciary duty by the directors to the corporation. Although these suits are generally brought by a state attorney general, some states allow other directors, and in some instances members to bring such suits (e.g. California). See generally, Hansmann, H., Reforming Nonprofit Corporation Law, 129 UNIV. OF PENNSYLVANIA L.R. 497, 618 (1981).

\textsuperscript{134} This is often referred to as piercing the corporate veil. See Balda, supra note 129, at 77; and generally Schlicht, J. C., Piercing the Nonprofit Corporate Veil, 66 MARQUETTE L. R. 134, 159 (1982).
organizations can be involved in lobbying and political activities, and (4) identified IRS’ efforts to monitor their activities.\textsuperscript{135}

The results of the GAO study suggest that, although Section 501(c)(4), (5), and (6) organizations as a group are smaller in total than 501(c)(3) charitable organizations, there are substantial grounds for concern over their activities. In general the number (now nearly 300,000 strong) and size (assets grew to over $68 billion) of these organizations increased substantially over the last 20 years. These organizations in aggregate now account for nearly $50 billion in annual revenues and expenditures. Interestingly, although social welfare (Section 501(c)(4)) organizations declined in number by about 18 percent and decreased in revenue by some 47 percent, their assets grew by more than 20 percent to over $35 billion. Labor and agricultural organizations (Section 501(c)(5)) grew in both number (18 percent) and size (47 percent to over $14 billion), as did business leagues (Section 501(c)(6), by 45 percent in number and 140 percent to over $19 billion in size). Although audits of all 501(c)(4), (5), and (6) organizations decreased by 30 percent between 1990 and 1994, taxes and penalties resulting from these examinations increased about 200 percent. The majority of these assessments resulted from disputes over commercial activities. In addition the IRS revoked the tax exempt status of 67 of these organizations in the last 4 years.

Some 46 of the largest of these organizations were examined for executive compensation levels. More than 100 officers, directors and key employees (about 15 percent of the total in these 46 organizations) were paid in excess of $200,000 (six of whom earned $1 million or more!). Business leagues had the largest number of executives receiving more than $200,000 with 90. Labor organizations had the most executives making between $100,000 and $200,000 with 73. The PGA Tour, Inc., an exempt business league, paid the highest total 1992 compensation of any exempt organization ($4.1 million) to its Commissioner. The highest paid officer of an exempt social welfare organization was the Chair of the Mutual of America Life Insurance Company who received $1.2 million. The highest compensated officer of an exempt labor or agricultural organization was the Executive Director of the Major League Baseball Players Association at over $900,000.

The report criticized the IRS for being too lenient in the granting of all types of exemptions. For 1992, the GAO reported the IRS received more than 57,000 exemption applications of which they approved nearly 44,000 (77 percent) and denied fewer than 1000 (2 percent). The others were either withdrawn or were still pending. The study pointed out that the Service may not be appropriately enforcing the current prohibitions on private inurement. The GAO did agree later, however, that the Service is woefully understaffed and funded in exempt organization examination and compliance areas.

It appears from this report that many of the same compliance problems discussed above for charitable organizations may be prevalent in these other organizations. The issue of unreasonable compensation immediately comes to mind; the possibility of founders and other key employees taking advantage of these
organizations is certainly present; issues associated with the growth of this subset and the resultant complexity; organization and application issues; and obviously commercial activities all appear to be issues of concern for this large subset of exempt organizations. Thus, many of the same legislative or enforcement options may be effective in controlling unproductive behavior. Summarized below in roughly the same order, are those options identified as applicable to Section 501(c)(3) charitable organizations which could improve compliance by these other organizations. Once again, although much of this discussion would generally be considered to be beyond the scope of this analysis, there is value in outlining these issues herein to begin the debate and bring attention to the need for additional study.

Discussion. There is some question as to the effectiveness of increased state or federal government regulation of nonprofit organizations, particularly smaller organizations. Most of the current law derived from general business corporation law, and generally is considered sufficient and effective for dealing with most large organizations. Perhaps existing regulation would be sufficient if it were consistently and aggressively enforced. Since this is apparently unlikely to occur, consideration should be given to what new tax policy, regulation or enforcement mechanisms might positively affect compliance.

136Moody, in RESEARCH AGENDA: LEGAL ISSUES, supra note 85, at 29.

137See Fishman, supra note 126.

138Moody, in RESEARCH AGENDA: LEGAL ISSUES, supra note 85, at 28 ("[L]arge organizations are relatively well served by existing . . . statutes.").
More Concrete and Specific Exemption Requirements. Few of the subparagraphs under Section 501(c) are very specific, but rather use vague and nonspecific words such as “charitable,” “fraternal,” “benevolent” or “mutual benefit.” However, Section 501(c)(12) does contain more specific exemption requirements for cooperatives. Many rural electric associations, rural phone or water companies are organized as exempt cooperatives. In general 85 percent of the income of the cooperative must be from providing services to its members in order for it to retain its exempt status. Perhaps some similar standard could be developed for other subcategories of exempt organizations. For example a similar limit might work for exempt business leagues or chambers of commerce who provide member services for a fee.

Adding an implicit inurement prohibition is another legislative option for certain noncharitable nonprofits. These organizations, including those described in Section 501(c)(4), (5), (8), (10), (12) and others, should have the same types of specific requirements as charities in order to prevent looting. 139

Organization and Application Requirements. The form of application for exemption for noncharitable organizations (Form 1024—Appendix D) is only 18 pages (compared with 29 for 501(c)(3)s) even though it deals with 16 distinct subparagraphs. Form 1024 similarly may place too much emphasis on organizational form and on finances and not enough emphasis on service efforts and accomplishments. The aspect of speculation as to future activities is also present as in exemption applications for charitable organizations. What may be needed with these

organizations is more emphasis on service efforts and accomplishments; better follow-up by the Service to evaluate whether organizations are meeting the service goals they represented when asking for exemption; a period of operation prior to granting of exemption; posting of a payment or performance bonds; and/or increased application fees.

Founders, Family Members and Others in Control. Requiring that organizations, including noncharitable nonprofits, have less than 50 percent voting control vested in founders and their family members would most likely decrease the incidence of self-dealing type transactions perhaps having a positive affect on enforcement. Using control for private benefit is probably less likely in an association, particularly one with a large membership, but there are instances like in labor unions where founders have exercised undue influence.140

Commercial Activity. The GAO study mentioned above made it clear that commercial activity was an important problem issue for noncharitable nonprofits.141 More active enforcement of existing regulations coupled with more specific standards such as those described above for charitable nonprofits could improve enforcement.

Other Enforcement Options. As for charities, enforcement of exemption requirements for noncharitable nonprofits could be improved with the addition of

140See e.g., Bill Wildt's Motorsport Advancement Crusade, 56 TCM 1401 (1989).

141GAO REPORT, supra note 135, at 747 (“A clear problem exists when audits decreased by 30 percent yet, collections increased by 200 percent. A majority of these assessments resulted from examinations of IRS FORM 990T, EXEMPT ORGANIZATION BUSINESS INCOME TAX RETURN.”).
increased penalties for fraud and negligence; and swift prosecution of and stiff penalties for misrepresentations as to exemption and deductibility of contributions. Finally, a review of the historical basis for exempting some of these 25 subcategories might be appropriate to decide on a larger political scale whether those exemptions are still warranted. For instance, the inclusion of many mutual insurance companies under Section 501(c)(4) or (10) may no longer be justifiable given the size and financial strength of these companies and their lack of dissimilarity to forprofit insurance companies.

The Problem With Intermediate Sanctions

Introduction. Although detailed discussion of legislative proposals generally would not be a requirement of an analysis of this type, it might be useful to have a better understanding of the proposal and its potential shortcomings since it is aimed at Congress' perception of charities' behavior problems, some of which were documented in the case law. The reason these proposed rules are called "intermediate" is because they do not go as far as the "ultimate" sanction which is withdrawal of exemption when an illegal act is to be punished. The proposal applies to both Section 501(c)(3) and (4) organizations and is aimed at any "excess benefit" provided to any "insider."¹⁴²

Excess benefit includes any compensation in excess of reasonable compensation, and any transfer, lease, license, or loan of property to or from an insider

if the insider underpays or the charity overpays for the property. A penalty tax at an initial rate of 25 percent is imposed on any insider engaged in these transactions. Insiders include officers; directors; trustees; any other person with the power to exercise substantial influence over organizational decisions; any former insider; and members of an insider’s family.

The excess benefit is required to be repaid “with appropriate interest”\(^{143}\) or otherwise corrected or, a second tier tax of 200 percent of the amount of the excess benefit may be imposed. In addition, the organization’s managers (officers, directors, trustees or key employees) who approved the transaction knowing that it constituted an excess benefit would be subject to a tax equal to 10 percent of the amount of the excess benefit.

There is a provision for abatement of the first tier tax if the violation were corrected within a correction period and the organization could demonstrate the violation was due to reasonable cause. The standard for reasonable cause, however, remains undefined. The standard for reasonable compensation is proposed to include existing tax law standards for forprofit organizations. Substantial weight would be given to approval of the compensation arrangement by a truly independent board if the board exhibited a history of taking its fiduciary responsibilities seriously and the amount was otherwise deemed reasonable.

If intermediate sanctions were imposed they would be the sole sanction. That is, the IRS could not revoke the organization’s exempt status due to that specific

violation. These sanctions would apply also to organizations that were terminating their status as a Section 501(c)(3) or (4) organization until the organization distributed all its assets to another qualified organization or paid a termination tax equal to 100 percent of its assets. Finally, new mandatory disclosures of financial data would be required.

The Good, the Bad, and the Ugly. There has been surprisingly little opposition to the idea of intermediate sanctions in lieu of exemption revocations. There appears to be substantial agreement that these sanctions are needed and could have a positive impact on enforcement efforts. This does not mean, however, these provisions are not without problems. Summarized below are what appears to be a number of the unresolved issues.

144 Id.

145 Carson, Marlis L., Cerney Predicts Success for Intermediate Sanctions Proposal, 9 EXEMPT ORGANIZATION TAX REVIEW 1203, (June 1994) (“Treasury's intermediate sanctions proposal will receive broad support . . .”). See also, Suhrke, H., Will Treasury's Proposal End Charitable Oversight as We Know It?, PHILANTHROPY MONTHLY, November 1993, at 7 (“The casual observer . . . may remonstrate: how can one object to a more rational process of penalizing transactions which are by definition illegal?”).

146 Attributed to Congressman J. Pickle in Samuels, supra note 143, at 11 (“The conclusion everyone seems to have reached is that IRS cannot deal effectively with inurement because of the severity of the only sanction available.”).

147 Suhrke, H., What's Wrong With Intermediate Sanctions, PHILANTHROPY MONTHLY, November 1993, at 5. See also, Murawski, supra note 106, at 45 (“Charities like the idea of adding the fines because it spares them the threat of losing their tax exemption because of misconduct by one employee.”).

148 Benner, Avner and Van Hoomissen, Theresa, The Governance of Nonprofit Organizations: Law and Public Policy, 4 NONPROFIT MANAGEMENT & LEADERSHIP
Interplay with the Public Benefit Test of the Statute. There is great confusion about how these provisions would interface with the existing exemption requirements. Violations by an organization as a whole constituting failure of the operational test would still call for revocation of exemption.\textsuperscript{149} An isolated instance involving private inurement with an insider could be dealt with through a fine or other penalty. But the proposal does not extend to outsiders (the private benefit test). Thus, a transaction with an outsider could be treated more harshly (revocation of exempt status) than the same transaction with an insider (25 percent excise tax).

The Process Was Flawed. Despite the fact that this discussion has been going on for over 2 years and that there have been a number of public hearings on the matter, the process to develop these proposals has been seriously flawed. For instance, the Assistant Secretary of the Treasury for Tax Policy, Leslie Samuels admitted the evidence supporting this proposal was “anecdotal.”\textsuperscript{150} It has been implied that the public hearings were stacked with “selected [government] yesmen” resulting in a slanted view.\textsuperscript{151} There were no organizations at the hearings that have been accused of these purported abuses to give their side of the story. In fact many of the hearings were held in “executive session,” which means out of the public eye, supposedly to protect these abusive organizations’ identities. It has been intimated, however, this

\begin{footnotesize}
\textsuperscript{149} Streckfus, \textit{supra} note 131, at 1201.

\textsuperscript{150} See Suhrke, \textit{supra} note 147, at 6.

\textsuperscript{151} \textit{Id.}
\end{footnotesize}
served only to protect government interests. Thus, it appears that the nonprofit sector was under- or misrepresented at the hearings.

This Legislation Constitutes an Excessive Intrusion into Nonprofit Governance. The IRS will be in the position of determining whether the board of the nonprofit, in approving compensation levels, was "truly independent." Mr. Samuels is attributed with saying the board's judgment would be "given very little weight." "Defining board responsibility and insuring that a board is in fact ‘truly’ independent and acts in accordance with . . . well established duties of care, loyalty, etc., is a process supported by hundreds of years of law and individual contests decided . . . over long periods of time." The very essence of nonprofit governance would thus, be usurped by the IRS, which is ill equipped to evaluate the individual circumstances of hundreds of thousands of these organizations, or to evaluate applicable market conditions which contributed to the initial board decisions.

This Legislation Constitutes an Unwarranted Intrusion into States' Rights. The enforcement of issues of due care, breaches of fiduciary duty and responsibility are issues properly left to the attorney general for the state in which the organization was chartered. Otherwise, what's the point of having state nonprofit corporation acts?

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152 Id.

153 Suhrke, supra note 145, at 7.

154 Id.

155 Suhrke, supra note 147, at 8 ("Nonprofits would be ill-advised to celebrate that IRS would have available less lethal weapon to use against them. Instead they should consider the price: another expert with enforcement powers sitting at the table as the board does its regular work.").
The state's already possess the necessary regulatory tools to deal with these abuses, but have either not seen it as a serious enough problem to compel impugning nonprofit authority or, have at least not seen it as a high enough priority to allocate additional resources to increased enforcement.

IRS would be in the position of government-as-blackmailer: holding the power to threaten in secret heavy fines unless you confess to judgmental error and change your practices. There is no public process by which the charity can defend itself. For it or IRS to 'go public' would dry up contributions and alienate public support. This dilemma is one of the reasons for the attorney generals’ primary role in nonprofit oversight and for separating tax exemption issues from judgmental governance issues.\(^{156}\)

The Costs to the Nonprofit Sector Are Too High. The costs to the sector are not only from the estimated $13 million in taxes expected to be generated from enforcement, but include increased costs of liability insurance, directors’ and officers’ insurance, legal fees to defend IRS’ charges, additional expense to document board decisions, and additional costs to recruit board members and officers who will be reluctant to serve under these conditions.\(^{157}\)

In addition, the part of the proposal calling for additional disclosure would require increased costs of accounting and reporting, costs associated with making copies of annual reports available, increased printing and postage costs, and increased fines for untimely or incomplete returns. Most nonprofits can ill afford any of these costs.

\(^{156}\) Id. at 9.

\(^{157}\) Id.
The Proposal Is Not Directed at the Major Areas of Abuse. One of these major areas is nonexempt organizations holding themselves out as charitable. Despite the recommendation of the Subcommittee,\textsuperscript{158} there is no provision in the proposal to punish noncharitable organizations from representing themselves as charitable. It is unconscionable to suggest confiscatory taxes be imposed upon legitimate charitable and social welfare entities for a mistake in judgment when outright fraud by nonexempt organizations goes unpunished under the proposal.\textsuperscript{159}

The proposal aims primarily at “excess benefits” (read unreasonable compensation) previously documented to be a relatively minor problem in exemption cases. The proposal would presumably get at the issue of payment of personal expenses, but does not effectively deal with commercial activities, retained interests, tax avoidance schemes, insufficient public benefit, excess lobbying and political action, organization and application issues and the myriad of other violation types documented in the case law.

\textsuperscript{158}Streckfus, P., Misleading Claims of Tax Exempt Status, 9 EXEMPT ORGANIZATION TAX REVIEW 1231 (June 1994).

\textsuperscript{159}\textit{Id.} (The example provided by the Subcommittee was of a taxable insurance company describing itself as “a nonprofit association ... formed to mobilize members for charitable work.”).
Conclusions

What Has Been Accomplished?

Described in one place now are the major theories and many of the minor theories or rationales for tax exemption. Criteria have been identified from those theories, and from the law and literature, which can be used by which to judge nonprofit behavior. A body of case law has been identified which can be and in fact, was analyzed for patterns of illegal behavior outside these established criteria. A crisis of confidence in nonprofit management and governance has been described and documented. Numerous patterns of illegal behavior were identified from the case law which suggest new or different tax policy, regulatory responses, enforcement mechanisms and/or ethical standards are needed. The various forms of violations were summarized in a Typology of Violations (Figure 3.1) and the patterns were summarized in Chapter 4 so they will not be enumerated again here. Many original and even unconventional ideas were suggested by the case law and the related patterns for management strategies, regulatory schemes and enforcement mechanisms.

These strategies, schemes and mechanisms were reviewed for options to current practice in noncharitable organizations. It was concluded that there may be improvements in management and governance for the entire sector to be gleaned from what was learned about charities. And proposed legislation has been reviewed for appropriateness and found to be lacking in process and execution and thus, in addressing many of the public’s concerns evidenced in the “literature of crisis.”
What Does It All Mean?

To think that, through regulation, it might be possible to control every person’s actions or ethics has no basis in reality. A healthy skepticism towards government claims to the contrary are well justified. Thus, it is necessary to examine any regulatory proposal dealing with the correction of perceived abusive behaviors and to be prepared to object to all or specific parts of it, and/or on principle alone.

Nonprofit leaders can simply accept new regulation, for there will be more to come; they can oppose it out of hand; or, “it follows that a wise approach is to coopt the regulatory process.” What this study has done is provide some of the information and tools necessary to coopt the process by providing information about the nature and typology of illegal behaviors, the inclination and success of the Service in litigating these issues and by providing possible strategies for dealing with dysfunctional behaviors. At least a few steps may have been taken toward answering some of the most difficult and long debated questions about the definition of charity and the criteria for granting tax exempt status.

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160 Hall, Peter Dobkin, The Best of Times, The Worst of Times, A Report on the State of Nonprofit Research, PHILANTHROPY MONTHLY, December 1992, at 10 (“[T]he nonprofit industries should have learned in 1969, legislative bodies, operating on imperfect information, tend to throw out the baby with the bathwater.”).


162 Hall, P., supra note 160, at 11 (“The better the quality of information and understanding available to the public and their representatives, the more enlightened and informed the public policies affecting nonprofits will be.”).

What's Left to be Done?

"The political battle for the exemption is winnable . . . because the virtues of charity that we have . . . are close to the core values of our culture."164 There will still be battles and there will still be needs for information to inform political decisions. Thus, there is still a lot of research to be done to understand the true nature of charity and philanthropic organizations and to understand their actions and motivations.165 This study cannot address nor would this author presume to suggest answers to the myriad of unanswerable questions. Those that do so presume should be looked upon with great suspicion.166

Of great concern should be the coming "$10 Trillion Wealth Transfer" of the baby boomer generation.167 There are only 4 places these funds can go: 1) they will be consumed during life through payments to long term caregivers or otherwise; 2) they will go to heirs; 3) they will go to taxes; or 4) they will go to charity. This raises

164 Atkinson, in RATIONALES, supra note 19, at 51.

165 Hall, P., supra note 160, at 11 ("While the growth of the research infrastructure has placed the nonprofit industries in a far better position to give an account of themselves than they were a quarter of a century ago, very little of that research has focused on the arenas . . . where the major challenges are likely to occur.").

166 See e.g., Suhrke, H., Authors with an Attitude?, PHILANTHROPY MONTHLY, Jan./Feb. 1995, at 9 ("As is frequently the case with theorists these days, they are not satisfied with theory . . . they want their theory put into practice . . . . Nor are they modest or tentative about the result: 'Adoption of the theory . . . will solve all of the major pending controversies surrounding the charitable exemption.'") (footnote omitted).

the question as to what is the optimal size of the charitable sector? And should that size be regulated in some way? Given the choice between death taxes and charity, most individuals will choose charity. Thus, a very large portion of this wealth may end up in the hands of nonprofit organizations, many of whom are ill-equipped to handle it.

Unfettered, the growth of the third sector could even result in it surpassing the government in size with all the resulting bureaucracies and inefficiencies.168 Rapid unregulated growth is one reason given for the scandals of recent years.169 This wealth may increase the temptations to persons with noncharitable aims to pursue charitable structures for personal gain.

Also in need of additional study are the redistributive effects of nonprofits.170 People who give to nonprofits do not, as many suggest, give out of a pure sense of altruism, but often “people don’t want to help the truly disadvantaged . . . they want to help who they want to help.”171 This self interest and its effect on the creation and perpetuation of nonprofit organizations needs to studied. It may reveal new and interesting motivations and may affect the justification for exemption extended to some. For instance, what is often disguised as religious or intellectual freedom,


169 Hall, P., supra note 160, at 9. See also, Gaul and Borowski, supra.


171 Zimmerman, Ulf, Exploring the Nonprofit Motive (or: What's in it for You?), 54 PUBLIC ADMINISTRATION REVIEW 400, (July/August 1994).
democratic pluralism, promotion of minority interests, or flexibility is often mere self indulgence. In much of the arts the line between public benefit and private benefit is substantively blurred. "Art for art's sake" is double talk for self indulgence. Can this be a satisfactory basis for exemption in the future? It is not clear.

Other topics which should be of interest to researchers include: 1) the unrelated business income tax; 2) antitrust law and its application to nonprofits; 3) continuing attacks on charitable solicitation; 4) investments by nonprofits; 172 5) contribution and deduction rules; 6) the role of charities in shaping public policy (e.g. health policy, foreign policy, liberalism, etc.); 173 7) comparative studies with foreign nonprofit sectors; 8) other funding mechanisms (e.g. direct governmental grants); 9) organizational form and structure; 174 10) employment relations; and many others yet to be discovered.

As to broad theories or rationales for exemption, it appears Hansmann's contract failure is still the most complete and accurate to date. 175 However, many are

172 Hansmann, in RESEARCH AGENDA: LEGAL ISSUES, supra note 45.


174 Moody, in RESEARCH AGENDA: LEGAL ISSUES, supra note 85.

175 Steinberg and Gray, supra note 168, at 312-313 ("Hansmann's analysis of the role of nonprofit organizations is appealingly elegant . . . . Contract failure theory is central to many public policy debates surrounding the sector. It provides a justification for including a well defined nondistribution constraint in any nonprofit corporation statute . . . and for refining and enforcing the definitions of fair compensation, self dealing, and private inurement. Contract failure may justify the differential tax treatment of nonprofit income . . . but current research is a long way from delineating the optimal tax structure in particular nonprofit industries.").
still looking for that holy grail. Whether one simple overarching theory for such a large and diverse group of entities will ever be discovered is unknown. The looking, however, provides significant insight into the workings of the sector and so is beneficial regardless. The growth of nonprofit degree and certificate programs at universities is encouraging, but it will not fully satisfy the need for ongoing basic research concerning the sector.

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177 Hall, P., supra note 160.
APPENDIX A

CASES

2. Ackerman, Martin S., Fdtn., 52 TCM 152 (1986)
5. Aid to Artisans Inc. v. Comm., 71 TC 202 (1978)
7. Akron Clinic Fdtn., 64-1 USTC 9233 (DC 1964)
10. Alumnae Chapter Beta of Clovia, 46 TCM 297 (1983)
11. American Campaign Academy, 92 TC 1053 (1989)
cert. den. 372 US 976 (1963)
15. American Science Fdtn., 52 TCM 1049 (1986)
16. Americans United, Inc., 74-1 USTC 9439, rev'd 73-1 USTC 9165


19. Animal Protection Institute, Inc., 78-2 USTC 9709


22. Associated Hospital Services, Inc., 74 TC 213 (1980)


25. Basic Bible Church, 74 TC 846 (1980)

26. Basic Unit Ministry of Alma Karl Shurig, 81-1 USTC 9199, aff'd per curiam 82-1 USTC 9141 (CA-DC 1982)


28. Benjamin Price Genealogical Ass'n., Inc., 79-1 USTC 9361 (DCDC 1979)

29. Best Foundation, 29 TC 389 (1957)

30. Best Lock Corp., 31 TC 1217 (1959)


33. BGS Fdtn., 63-1 USTC 9116 (DC-TX 1963)
34. BHW Anasthesia Fdtn. Inc., 72 TC 681 (1979)
36. Big Spring Cowboy Reunion, 54-1 USTC 9232 (1954)
40. Bob and Delores Hope Charitable Fdtn., 61-1 USTC 9437 (DC 1961)
41. Bob Jones University, 81-1 USTC 9124, aff'd 83-1 USTC 9366 (Sup. Ct. 1983)
42. Boman v. Comm., 57-1 USTC 9344
43. Boy's, Inc. of America, 66-2 USTC 9533 (DC-TX 1966)
45. Bright Star Foundation, 61-1 USTC 9139 (DC 1961)
46. Broadway Theatre League of Lynchburg VA, Inc., 68-2 USTC 9658 (DC VA 1968)
47. Bronner v. Comm., 72 TC 368 (1979)
48. BSW Group, Inc., 70 TC 352 (1978)
49. Bubbling Well Church of Universal Love, Inc., 74 TC 531 (1980), aff'd 82-1 USTC 9258 (CA-9 1981)
50. Burke v. Comm., 91 TNT 86-10 (2nd Cir. 1991)
54. Calhoun Academy, 94 TC 284 (1990)
55. Callaway Family Assoc., Inc., 71 TC 340 (1978)
60. Center on Corporate Responsibility, 74-1 USTC 9118 (1974)
62. Charleston Chair Co. v. U. S., 62-1 USTC 9250
63. Chart, Inc. v. U. S., 79-2 USTC 9735
64. Chase, W.B., Fdtn., 19 TCM 234 (1960)
68. Christian Stewardship Assistance, Inc., 70 TC 1037 (1978)
72. Church of Eternal Life & Liberty, Inc., 86 TC 916 (1986)
74. Church of Gospel Ministry, Inc. 86-2 USTC 9497 (DC-DC 1986)
75. Church of Modern Enlightenment, 55 TCM 1304 (1988)
76. Church of Nature in Man v. Comm., 49 TCM 1393 (1985)
78. Church of Spiritual Technology, 90-1 USTC 50,097 (Ct.Cl. 1990), also 90-2 USTC 50,386 (1990)
79. Church of the Chosen People, 82-2 USTC 9646 (DC-Minn. 1982)
80. Church of the New Testament, 85-1 USTC 9227
82. Church of the Visible Intelligence that Governs the Universe, 83-2 USTC 9726 (1983)
84. Cigelman, 14 TCM 1259 (1955)
85. Cleveland Chiropractic College, 21 TCM 1, aff'd 63-1 USTC 9200 (CA-8 1963)
86. Cleveland Creative Arts Guild v. Comm., 50 TCM 272 (1985)
87. Clippinger v. Comm., 37 TCM 44

90. Coit v. Green, 71-2 USTC 9529, aff'd 72-1 USTC 9123A (Sup.Ct. 1972)


92. Columbia Parks and Recreation Ass'n., 88 TC 1 (1987)

93. Community Services, Inc., 55-1 USTC 9196

94. Cone v. McGinnis, 63-2 USTC 9551 (DC 1963)


96. Consumer Credit Counseling Service of Ala., Inc., 78-2 USTC 9660 (DC 1978)


101. Credit Counseling Ctrs.of Okla., 79-2 USTC 9468 (1979)

102. Crenshaw County Private School Fdtn., 73-1 USTC 9287 (1973)

103. Danforth Fdtn., 63-2 USTC 9747 (1963)

104. Danz Charitable Trust v. U.S., 284 F.2d 726 (9th Cir. 1961), aff'g 32 TC 469 (1959)

105. Davis, et. al. Trustees of Columbus Youth Fdtn., 62-1 USTC 9156 (DC 1962)
106. Davis, James J., et. ux. v. Comm., 81 TC 806 (1983), aff'd 767 F.2d 931 (9th Cir. 1985)


110. Duluth Clinic Fdtn., 67-1 USTC 9226 (DC 1967)

111. Dumaine Farms, 73 TC 650 (1979)


114. Eaton Fdtn., 12 TCM 210, aff'd 55-1 USTC 9248 (CA-9 1955)

115. Ecclesiastical Order of the Ism of Am, Inc., 80 TC 833, aff'd unpublished opinion (CA-6 1988)


118. Biry Trust, 77 TC 1263 (1981)


121. Engert, R.A., 51 TCM 1022 (1986), see also 58 TCM 1319 (1990)

122. Enterprise Ry. Equip., 58-1 USTC 9508 (Ct.Cl. 1958)

123. Erie Endowment v. U.S., 62-1 USTC 9173, aff'd 63-1 USTC 9373 (CA-3 1963)

124. est of Hawaii, a Hawaiian Corp., 71 TC 1067 (1979)
129. Estate of Phillip Thayer v. Comm., 24 TC 384 (1955)
132. Fides Publishers Assoc., 67-1 USTC 9251 (DC-Ind. 1967)
133. First Dallas Charitable Corp., 63-1 USTC 9117 (DC-TX 1963)
134. First Libertarian Church, 74 TC 396 (1975)
137. Foree Fdtn., 63-1 USTC 9115 (DC-TX 1963)
139. Forest, Charles W., et. ux. v. U.S., 90 TNT 136-25 (9th Cir. 1990)
140. Foundation of Human Understanding, 88 TC 1341 (1987)
141. Founding Church of Scientology, 69-2 USTC 9538 (Ct. Cl. 1969), cert. den. 397 US 1009 (1970), 92 TNT 113-23
142. Fraternal Medical Specialist Services, Inc., 49 TCM 289 (1984)
143. Freedom Church of Revelation v. U.S., 84-1 USTC 9485 (DCDC 1984)
144. Freedom Church, 80-1 USTC 9132 (CA-1 1980)
145. Friedland Foundation, 56-2 USTC 9896 (DC-NJ 1956)
146. Geisinger Health Plan v. Comm., 94 TNT 149-14 (3rd Cir. 1994), aff'g 100 TC
No. 26, 93 TNT 96-18 (1993)
147. Gemological Institute of America v. Comm., 17 TC 1604, 1609 (1952), aff'd
per curiam 54-1 USTC 9339 (CA-9 1954)
148. Gemological Institute of America v. Riddell, 57-1 USTC 9418 (DC CA 1957)
149. General Conference of the Free Church of Amer., 71 TC 920 (1979)
151. Golden Rule Church Ass'n., 41 TC 719 (nonacq.) (1964)
Green, 404 US 997 (1971)
159. Green, Wm.H., v. Kennedy, 70-2 USTC 9600 (DCDC 1970), see also 70-1
USTC 9176 (DCDC 1970)
160. Griswold, Donald G., 39 TC 620 (1962)
161. Hall v. Comm., 84-1 USTC 9341


163. Hancock Academy of Savannah, Inc., 69 TC 488 (1977)

164. Harding Hosp., Inc., 73-1 USTC 9421, aff'd 74-2 USTC 9816 (CA-6 1974)


167. HCSC Laundry, 79-2 USTC 9532, 80-2 USTC 9483, 81-1 USTC 9483 (Sup.Ct. 1981)


169. Hisacres New Thought Center, 22 TCM 642 (1963)


171. Horace Heidt Fdtn., 59-1 USTC 9289 (Ct. Cl. 1959)

172. Hospital Bureau of Standards & Supplies, 58-1 USTC 9194 (Ct.Cl. 1958)

173. Hospital Central Services Ass'n., 80-2 USTC 9570


175. Houston Lawyer Referrel Service, Inc., 69 TC 570 (1978)


178. Human Engineering Institute, 37 TCM 619, aff'd 80-2 USTC 9600 (1980)

179. Huron Clinic Foundation, 63-1 USTC 9215, rem'd 63-2 USTC 9771 (CA-8 1963)
180. Hutchinson Baseball Enterprises, Inc., 73 TC 144, aff'd 83-1 USTC 9111 (CA-10 1982)


182. Indiana Crop Improvement Ass'n., Inc., 76 TC 394 (1981)

183. Industrial Aid for the Blind v. Comm., 73 TC 96 (1979)

184. Institute for Trend Research, 55-2 USTC 9728 (DC 1955), aff'd per curiam 56-1 USTC 9382 (CA-1 1956)

185. Institute of Pacific Relations, 59-1 USTC 9425 & 60-1 USTC 9404 (DC-NY 1960)


188. International Postgraduate Medical Fdtn., 56 TCM 1140 (1989)


190. Jarie Corp., 22 TCM 726 (1963)


194. Johnson, Earl, Exr., 30 TC 909, aff'd 59-2 USTC 9504 (CA-1 1959)


196. Jordan Fdtn., 12 TCM 109, rev'd 54-1 USTC 9269 (CA-7 1954)
197. Junaluska Assembly Housing, Inc., 86 TC 1114 (1986)
198. Kalgaard v. Comm., 85-2 USTC 9513, aff'g TCM 1984-283
203. King Shipping Consum., Inc., 58 TCM 574 (1989)
204. Kluss v. Comm., 46 TC 572 (1966)
206. Kolkey, Emanuel N. (Kyron Fdtn.), 27 TC 37 (1956), aff'd 58-1 USTC 9435 (CA-7 1958)
207. La Verdad v. Comm., 82 TC 219
209. Leon A. Beeghly Fund v. Comm., 35 TC 490, aff'd 63-1 USTC 9101 (CA-6 1963)
210. Lesavoy Fdtn., 57-1 USTC 9229 (1957)
211. Levin Fdtn., 24 TC 15 (1955)
212. Levy Family Tribe Fdtn., Inc., 69 TC 615 (1978)
213. Lewis, E.S., 61-1 USTC 9231 (DC-Wyo. 1961)
215. Lichter Fdtn., 56-2 USTC 9835, rev'd & rem'd 57-2 USTC 9910 (CA-6 1957), 59-2 USTC 9571 (CA-6 1959)

216. Linwood Cemetery Ass'n., 87 TC 1314 (1986)

217. Lions Associated Drag Strip, 64-1 USTC 9283 (DC-Calif. 1964)

218. Living Faith, Inc. v. Comm., 91 TNT 260-15 (7th Cir. 1991), affg TCM 90-484, 90 TNT 187-7

219. Local Union 712, IBEW Scholarship Trust Fund, 45 TCM 675 (1983)

220. Lorain Ave. Clinic, 31 TC 141 (1958)

221. Lowry Hosp. Assoc., 66 TC 850 (1976)


223. Lutheran Social Service of Minn., 84-1 USTC 9383, rev'd & rem'd 85-1 USTC 9316 (CA-8 1985)

224. Lynch, R.E., 41 TCM 204 (1980)


229. Manning Ass'n., 93 TC 596 (1989)

230. Marian Fdtn., 19 TCM 99 (1960)

231. Marie and Alex Mannoogian Fund v. Comm., 24 TC 412 (1955)


235. McGillick Fdtn., 30 TC 1130, aff'd & rev'd 60-2 USTC 9481 (CA-3 1960)
238. Metropolitan Detroit Area Hospital Services, 80-2 USTC 9767
240. Midwest Research Institute, 84-1 USTC 9113, aff'd 84-2 USTC 9815 (CA-8 1984)
243. Miss Georgia Scholarship Fund, Inc., 72 TC 267 (1979)
244. Mobile Arts & Sports Ass'n., Inc., 57-1 USTC 9359 (DC-Ala. 1957)
246. Morey v. Riddell, 62-2 USTC 9673
247. Munsell Color Fdtn., Inc., 74-1 USTC 9102 (DC-MD 1974)

253. Nationalist Movement v. Comm., 94 TNT 220-10 (5th Cir. 1994), aff'd 102 TC No. 102, 94 TNT 70-9


255. New Concordia Bible Church, 49 TCM 176 (1984)


259. Nittler, Alan H., 39 TCM 422 (1979)


263. Northern Calif Central Serv., Inc., 79-1 USTC 9165 (Ct.Cl. 1979)


266. Ohio Teamsters Educational & Safety Training Trust Fund, 77 TC 189, aff'd 82-2 USTC 9660 (CA-6 1982)


268. Old Dominion Box Co., 73-1 USTC 9364

269. Olney, R.C., 17 TCM 982 (1958)

272. Paratransit Insurance Corp. v. Comm., 102 TC No. 34, 94 TNT 115-7 (1994)
273. Parker Rehabilitation Fdn., Inc., 52 TCM 51 (1986)
274. Parker, Merle E. (Foundation for Divine Meditation), 24 TCM 411, aff'd, rev'd & rem'd 66-2 USTC 9647, cert. den. 87 S.Ct. 752 (1967)
276. Passaic United Hebrew Burial Ass'n., 63-1 USTC 9429 (DC-NJ 1963)
278. People of God Community, 75 TC 127 (1980)
279. Peoples' Translation Service/Newsfront Int'l., 72 TC 42 (1981)
282. Phinney v. Dougherty, 62-2 USTC 9717
286. Plumstead Theatre Society, Inc., 74 TC 1324, aff'd per curiam USTC 9358 (CA-9 1982)
289. Police Benevolent Ass'n of Richmond, VA, 87-1 USTC 9238 (DC-VA 1987)

291. Pollard v. Comm., 86-1 USTC 9331

292. Powell, W.L., Fdtn., 21 TC 279, rev'd 55-1 USTC 9398 (CA-7 1955)


295. Price Geneological Ass'n., 79-1 USTC 9361 (DCDC 1979)


300. Pulpit Resource, 70 TC 594 (1978)

301. Puritan Church of Amer., 10 TCM 485, aff'd per curiam 53-2 USTC 9601 (CA-DC 1953), cert den. 350 US 810 (1954)


304. Rabinovitz Fdtn., 17 TCM 958 (1958)


306. Randall Fdtn., 57-1 USTC 9352 (CA-9 1957)


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309. Riker, Peggy Lou, 14 TCM 903, aff'd 57-1 USTC 9588, cert. den. 355 US 839 (1957)
312. Ruud Int'l., 90-1 USTC 50,112 (DCDC 1990)
313. Saint Germain Fdtn., 26 TC 648 (1956)
314. San Francisco Infant School, Inc., 69 TC 957 (acq.) (1978)
315. Santa Cruz Bld'g. Ass'n., 76-1 USTC 9374 (DC-NJ 1976)
318. Science & Research Fdtn., 60-1 USTC 9252 (DC-IL 1960)
320. Seasonsgood, Murray, 22 TC 671, rev'd & rem'd 56-1 USTC 9135 (CA-6 1955)
322. Senior Citizen's Stores, Inc., 79-2 USTC 9592 (CA-5 1979)
323. Senior Citizens of Missouri, Inc., 56 TCM 480 (1985)
324. Shiffman, 32 TC 1073 (1959)
325. Sico Fdtn., 61-2 USTC 9732 (Ct.Cl. 1961)


328. Smith, Carl O., Exr. Est.of Bessie Sampson, 84-2 USTC 13,595 (DC-MO 1984)


331. Sonora Community Hosp., 46 TC 519 (1967), aff'd per curiam 68-2 USTC 9528 (CA-9 1968)

332. Sound Health Assoc., 71 TC 158, 185-187 (1978)

333. Southern Church of Universal Brotherhood Assembled, Inc., 74 TC 1223 (1975)

334. Southwest Charitable Corp., 63-1 USTC 9118 (DC-TX 1963)

335. Southwest Endowment Corp., 58-2 USTC 9577 (DC-TX 1958)

336. Spanish American Cultural Ass'n. of Bergenfield v. Comm., 94 TNT 201-14 (TCM 1994)

337. Spiritual Outreach Society, 58 TCM 1284 (1990), aff'd 91 TNT 51-12 (8th Cir. 1991)

338. St. Louis Science Fiction Ltd., 49 TCM 1126 (1985)

339. St. Louis Trust Co. v. U.S., 67-1 USTC 12457


341. State of Michigan and Michigan Education Trust, 94 TNT 221-4 (6th Cir. 1994)


344. Stevens Bros. Fdtn., 39 TC 93, aff'd, rev'd & rem'd in part 63-1 USTC 9820 (CA-8 1963), cert. den. 376 US 969 (1964)


347. Synanon Church, 84-1 USTC 9213, aff'd 87-1 USTC 9347


350. Teich Foundation, 48 TC 963, aff'd per curiam 69-1 USTC 9239 (CA-7 1969)

351. Tell Foundation v. Wood, 58-1 USTC 9111


353. Texas Trade School, 30 TC 642 (1958), aff'd per curiam 59-2 USTC 9786 (CA-5 1959)


355. Towe Antique Ford Foundation v. IRS, 93 TNT 161-22 (DC-WA 1993)

356. Triune of Life Church, Inc. v. Comm., 85 TC 45, aff'd in unpubl. opinion (CA-9 1986)

357. Truscott, Frank T., Trustee Holloway Fdtn., 58-1 USTC 9515 (DC-PA 1958)


363. United Hospital Services v. U.S., 74-2 USTC 9628


366. Univ. of Maryland Physicians, 41 TCM 732 (1981)


368. University Hill Foundation, 51 TC 548 (1969), rev'd 446 F.2d 701 (9th Cir. 1971), cert. den. 405 US 965 (1972)

369. Universal Church of Jesus Christ, Inc., 55 TCM 144 (1988)

370. Universal Church of Scientific Truth, 74-1 USTC 9360 (DC-Ala. 1974)

371. Universal Life Church, Inc., 72-1 USTC 9467, see also 74-1 USTC 9345, 76-2 USTC 9548 (DC 1976), 86-1 USTC 9271, 87-2 USTC 9617, 88-2 USTC 9485, 89-1 USTC 9152 (1989)

372. Universal Life Church, Inc., 87-2 USTC 9617 (Ct.Cl. 1987), aff'd per curiam 862 F.2d 321 (Fed. Cir. 1988)


378. Virginia Professional Standards Review, 79-1 USTC 9167
380. Walker, Arvin D., 37 TCM 1851 (1978)
381. Waller, W., 39 TC 665 (acq.) (1963)
## APPENDIX B

**Frequency of Violation Types for All Classes of Cases**

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<tr>
<th>Case</th>
<th>Class</th>
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<th>Exclusivity Violations</th>
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1. Appendix A
2. Figure 3.2, p. 139
3. Types and subtypes are described at Figure 3.1, p. 135
### Private Inurement Violations

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3. Types and subtypes are described at Figure 3.1, p. 135
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3. Types and subtypes are described at Figure 3.1, p. 135
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3. Types and subtypes are described at Figure 3.1, p. 135
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1. Appendix A
2. Figure 3.2, p. 139
3. Types and subtypes are described at Figure 3.1, p. 135
APPENDIX C

I.R.S. Form 1023, Application for Recognition of Exemption
Under Section 501(c)(3) of the Internal Revenue Code
Application for Recognition of Exemption
Under Section 501(c)(3) of the Internal Revenue Code

Read the instructions for each Part carefully.
A User Fee must be attached to this application.
If the required information and appropriate documents are not submitted along with Form 8718 (with payment of the appropriate user fee), the application may be returned to you.
Complete the Procedural Checklist in the instructions.

Part I Identification of Applicant

1a Full name of organization (as shown in organizing document)

1b c/o Name (if applicable)

1c Address (number, street, and room or suite no.)

1d City or town, state, and ZIP code

2 Employer identification number (If none, see instructions.)

3 Name and telephone number of person to be contacted if additional information is needed

4 Month the annual accounting period ends

5 Date incorporated or formed

6 Activity codes (See Instructions.)

7 Check here if applying under section:
a 501(c)(3)  b 501(c)(4)  c 501(c)(5)

8 Did the organization previously apply for recognition of exemption under this Code section or under any other section of the Code? [ ] Yes [ ] No

If "Yes," attach an explanation.

9 Is the organization required to file Form 990 (or Form 990-EZ)? [ ] N/A [ ] Yes [ ] No

If "No," attach an explanation (see instructions).

10 Has the organization filed Federal income tax returns or exempt organization information returns? [ ] Yes [ ] No

If "Yes," state the form numbers, years filed, and Internal Revenue office where filed.

11 Check the box for the type of organization. BE SURE TO ATTACH A CONFORMED COPY OF THE CORRESPONDING DOCUMENTS TO THE APPLICATION BEFORE MAILING (See Specific Instructions, Part I, Line 11.) Get Pub. 557, Tax-Exempt Status for Your Organization, for examples of organizational documents.

a Corporation- Attach a copy of the Articles of Incorporation, (including amendments and restatements) showing approval by the appropriate state official; also include a copy of the bylaws.

b Trust- Attach a copy of the Trust Indenture or Agreement, including all appropriate signatures and dates.

c Association- Attach a copy of the Articles of Association, Constitution, or other creating document, with a declaration (see instructions) or other evidence the organization was formed by adoption of the document by more than one person; also include a copy of the bylaws.

If the organization is a corporation or an unincorporated association that has not yet adopted bylaws, check here

I declare under the penalties of perjury that I am authorized to sign this application on behalf of the above organization and that I have examined this application, including the accompanying schedules and attachments, and to the best of my knowledge it is true, correct, and complete.

Please Sign Here

(Signature) (Title or authority of signer) (Date)

For Paperwork Reduction Act Notice, see inside.
Part II
Activities and Operational Information

1. Provide a detailed narrative description of all the activities of the organization—past, present, and planned. Do not merely refer to or repeat the language in the organizational document. Describe each activity separately in the order of importance. Each description should include, as a minimum, the following: (a) a detailed description of the activity including its purpose; (b) when the activity was or will be initiated; and (c) where and by whom the activity will be conducted.

2. What are or will be the organization's sources of financial support? List in order of size.

3. Describe the organization's fundraising program, both actual and planned, and explain to what extent it has been put into effect. Include details of fundraising activities such as selective mailings, formation of fundraising committees, use of volunteers or professional fundraisers, etc. Attach representative copies of solicitations for financial support.
## Part II Activities and Operational Information (Continued)

4. Give the following information about the organization's governing body:
   a. Names, addresses, and titles of officers, directors, trustees, etc.
   b. Annual Compensation

   c. Do any of the above persons serve as members of the governing body by reason of being public officials or being appointed by public officials?  
      - Yes □  No □
      If "Yes," name those persons and explain the basis of their selection or appointment.

   d. Are any members of the organization's governing body "disqualified persons" with respect to the organization (other than by reason of being a member of the governing body) or do any of the members have either a business or family relationship with "disqualified persons"? (See Specific Instructions, Part II, Line 4d.)  
      - Yes □  No □
      If "Yes," explain.

5. Does the organization control or is it controlled by any other organization?  
   - Yes □  No □
   Is the organization the outgrowth of (or successor to) another organization, or does it have a special relationship with another organization by reason of interlocking directorates or other factors?  
   - Yes □  No □
   If either of these questions is answered "Yes," explain.

6. Does or will the organization directly or indirectly engage in any of the following transactions with any political organization or other exempt organization (other than 501(c)(3) organizations): (a) grants; (b) purchases or sales of assets; (c) rental of facilities or equipment; (d) loans or loan guarantees; (e) reimbursement arrangements; (f) performance of services, membership, or fundraising solicitations; or (g) sharing of facilities, equipment, mailing lists or other assets, or paid employees?  
   - Yes □  No □
   If "Yes," explain fully and identify the other organizations involved.

7. Is the organization financially accountable to any other organization?  
   - Yes □  No □
   If "Yes," explain and identify the other organization. Include details concerning accountability or attach copies of reports if any have been submitted.

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For Paperwork Reduction Act notice, see instr. CS1  Form 1023 (Rev. 7-93)
Part II Activities and Operational Information (Continued)

8. What assets does the organization have that are used in the performance of its exempt function? (Do not include property producing investment income.) If any assets are not fully operational, explain their status, what additional steps remain to be completed, and when such final steps will be taken. If "None," indicate "N/A."

9. Will the organization be the beneficiary of tax-exempt bond financing within the next 2 years? (Do not include property producing investment income.) If any assets are not fully operational, explain their status, what additional steps remain to be completed, and when such final steps will be taken. If "None," indicate "N/A."

10a. Will any of the organization's facilities or operations be managed by another organization or individual under a contractual agreement? If either of these questions is answered "Yes," attach a copy of the contracts and explain the relationship between the applicant and the other parties.

11. Is the organization a membership organization? If "Yes," complete the following:
   a. Describe the organization's membership requirements, and attach a schedule of membership fees and dues.

   b. Describe your present and proposed efforts to attract members, and attach a copy of any descriptive literature or promotional material used for this purpose.

   c. What benefits do (or will) your members receive in exchange for their payment of dues?

12a. If the organization provides benefits, services or products, are the recipients required, or will they be required, to pay for them? If "Yes," explain how the charges are determined, and attach a copy of your current fee schedule.

   b. Does or will the organization limit its benefits, services or products to specific individuals or classes of individuals? If "Yes," explain how the recipients or beneficiaries are or will be selected.

13. Does or will the organization attempt to influence legislation? If "Yes," explain. Also, give an estimate of the percentage of the organization's time and funds which it devotes or plans to devote to this activity.

14. Does or will the organization intervene in any way in political campaigns, including the publication or distribution of statements? If "Yes," explain fully.
Part III Technical Requirements

1 Are you filing Form 1023 within 15 months from the end of the month in which your organization was created or formed?  
Yes  No

If you answer "Yes," do not answer questions on lines 2 through 7.

2 If one of the exceptions to the 15-month filing requirement shown below applies, check the appropriate box and proceed to question 8.

Exceptions - You are not required to file an exemption application within 15 months if the organization:

☐ (a) is a church, interchurch organization of local units of a church, a convention or association of churches, or an integrated auxiliary of a church (see instructions);
☐ (b) is not a private foundation and normally has gross receipts of not more than $5,000 in each tax year; or
☐ (c) is a subordinate organization covered by a group exemption letter, but only if the parent or supervisory organization timely submitted a notice covering the subordinate.

3 If the organization does not meet any of the exceptions on line 2, are you filing Form 1023 within 27 months from the end of the month in which the organization was created or formed?  
Yes  No


If "No," answer question 4.

4 If you answer "No" to question 3, has the organization been contacted by the IRS regarding its failure to file Form 1023 within 27 months from the end of the month in which the organization was created or formed?  
Yes  No

If "Yes," your organization qualifies for an extension of time to apply under the "reasonable action and good faith" requirements of section 5.01 of Rev. Proc. 92-85. Do not answer questions 5 through 7.

If "No," answer question 5.

5 If you answer "Yes" to question 4, does the organization wish to request relief from the 15-month filing requirement?  
Yes  No

If "Yes," give the reasons for not filing this application prior to being contacted by the IRS. See Specific Instructions, Part III, Line 5, before completing this item. Do not answer questions 6 and 7.

If "No," answer question 6.

6 If you answer "No" to question 5, your organization's qualification as a section 501(c)(3) organization can be recognized only from the date this application is filed with your key District Director. Therefore, do you want us to consider your application as a request for recognition of exemption as a section 501(c)(3) organization from the date the application is received and not retroactively to the date the organization was created or formed?  
Yes  No

7 If you answer "Yes" to the question on line 6 above and wish to request recognition of section 501(c)(4) status for the period beginning with the date the organization was formed and ending with the date the Form 1023 application was received (the effective date of the organization's section 501(c)(3) status), check here □ and attach a completed page 1 of Form 1024 to this application.
### Part III Technical Requirements (Continued)

8 Is the organization a private foundation?  
- Yes (Answer question on line 9.)  
- No (Answer question on line 10 and proceed as instructed.)

9 If you answer "Yes" to the question on line 8, does the organization claim to be a private operating foundation?  
- Yes (Complete Schedule E)  
- No

After answering the question on this line, go to Part IV.

10 If you answer "No" to the question on line 8, indicate the public charity classification the organization is requesting by checking the box below that most appropriately applies:

**THE ORGANIZATION IS NOT A PRIVATE FOUNDATION BECAUSE IT QUALIFIES:**

<p>| | | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(a)</td>
<td>As a church or a convention or association of churches (CHURCHES MUST COMPLETE SCHEDULE A.)</td>
<td>Sections 509(a)(1) and 170(b)(1)(A)(i)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(b)</td>
<td>As a school (MUST COMPLETE SCHEDULE B.)</td>
<td>Sections 509(a)(1) and 170(b)(1)(A)(ii)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(c)</td>
<td>As a hospital or a cooperative hospital service organization, or a medical research organization operated in conjunction with a hospital (MUST COMPLETE SCHEDULE C.)</td>
<td>Sections 509(a)(1) and 170(b)(1)(A)(vi)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(d)</td>
<td>As a governmental unit described in section 170(c)(1).</td>
<td>Sections 509(a)(1) and 170(b)(1)(A)(v)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(e)</td>
<td>As being operated solely for the benefit of, or in connection with, one or more of the organizations described in a through d, g, h, or i (MUST COMPLETE SCHEDULE D.)</td>
<td>Sections 509(a)(3)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(f)</td>
<td>As being organized and operated exclusively for testing for public safety.</td>
<td>Sections 509(a)(4)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(g)</td>
<td>As being operated as a college or university that is owned or operated by a governmental unit.</td>
<td>Sections 509(a)(1) and 170(b)(1)(A)(vi)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(h)</td>
<td>As receiving a substantial part of its support in the form of contributions from publicly supported organizations, from a governmental unit, or from the general public.</td>
<td>Sections 509(a)(1) and 170(b)(1)(A)(vi)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i)</td>
<td>As normally receiving not more than one-third of its support from gross investment income and more than one-third of its support from contributions, membership fees, and gross receipts from activities related to its exempt functions (subject to certain exceptions).</td>
<td>Sections 509(a)(2)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(j)</td>
<td>The organization is a publicly supported organization but is not sure whether it meets the public support test of block h or block i. The organization would like the IRS to decide the proper classification.</td>
<td>Sections 509(a)(1) and 170(b)(1)(A)(vi) or Section 509(a)(2)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

If you checked one of the boxes a through f in question 10, go to question 15.  
If you checked box g in question 10, go to questions 12 and 13.  
If you checked box h, i, or j, go to question 11.
Part III Technical Requirements (Continued)

11 If you checked box h, i, or j on line 10, has the organization completed a tax year of at least 9 months?
   Yes—Indicate whether you are requesting:
      A definitive ruling (Answer questions on lines 12 through 15.)
   No—You must request an advance ruling by completing and signing two Forms 872-C and attaching them to the application.

12 If the organization received any unusual grants during any of the tax years shown in Part IV-A, attach a list for each year showing the name of the contributor, the date and the amount of the grant.

13 If you are requesting a definitive ruling under section 170(b)(1)(A)(iv) or (vi), check here and:
   a Enter 2% of line 8, column (e) of Part IV-A
   b Attach a list showing the name and amount contributed by each person (other than a governmental unit or "publicly supported" organization) whose total gifts, grants, contributions, etc., were more than the amount entered on line 13a above.

14 If you are requesting a definitive ruling under section 509(a)(3), check here and:
   a For each of the years included on lines 1, 2, and 9 of Part IV-A, attach a list showing the name of and amount received from each "disqualified person." (For a definition of a "disqualified person," see Specific Instructions, Part III, Line 4d.)
   b For each of the years included on line 9 of Part IV-A, attach a list showing the name of and amount received from each payer (other than a "disqualified person") whose payments to the organization were more than $5,000. For this purpose, "payer" includes, but is not limited to, any organization described in sections 170(b)(1)(A)(ii) through (vi) and any governmental agency or bureau.

15 Indicate if your organization is one of the following, if so, complete the required schedule. (Submit only those schedules that apply to your organization. Do not submit blank schedules.)

<table>
<thead>
<tr>
<th>Question</th>
<th>Yes</th>
<th>No</th>
<th>If &quot;Yes,&quot; complete Schedule</th>
</tr>
</thead>
<tbody>
<tr>
<td>Is the organization a church?</td>
<td></td>
<td></td>
<td>A</td>
</tr>
<tr>
<td>Is the organization, or any part of it, a school?</td>
<td></td>
<td></td>
<td>B</td>
</tr>
<tr>
<td>Is the organization, or any part of it, a hospital or medical research organization?</td>
<td></td>
<td></td>
<td>C</td>
</tr>
<tr>
<td>Is the organization a section 509(a)(3) supporting organization?</td>
<td></td>
<td></td>
<td>D</td>
</tr>
<tr>
<td>Is the organization a private operating foundation?</td>
<td></td>
<td></td>
<td>E</td>
</tr>
<tr>
<td>Is the organization, or any part of it, a home for the aged or handicapped?</td>
<td></td>
<td></td>
<td>F</td>
</tr>
<tr>
<td>Is the organization, or any part of it, a child care organization?</td>
<td></td>
<td></td>
<td>G</td>
</tr>
<tr>
<td>Does the organization provide or administer any scholarship benefits, student aid, etc.?</td>
<td></td>
<td></td>
<td>H</td>
</tr>
<tr>
<td>Has the organization taken over, or will it take over, the facilities of a &quot;for profit&quot; institution?</td>
<td></td>
<td></td>
<td>I</td>
</tr>
</tbody>
</table>
Part IV Financial Data

Complete the financial statements for the current year and for each of the 3 years immediately before it. If in existence less than 4 years, complete the statements for each year in existence. If in existence less than 1 year, also provide proposed budgets for the 2 years following the current year.

A. Statement of Revenue and Expenses

<table>
<thead>
<tr>
<th>Revenue</th>
<th>Current tax year</th>
<th>3 prior tax years or proposed budget for 2 years</th>
<th>(a) From</th>
<th>(b) 19</th>
<th>(c) 19</th>
<th>(d) 19</th>
<th>(e) TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Gifts, grants, and contributions received (not including unusual grants—see instructions)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2 Membership fees received</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3 Gross investment income (see instructions for definition)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4 Net income from organization's unrelated business activities not included on line 3</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 Tax revenues levied for and either paid to or spent on behalf of the organization</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6 Value of services or facilities furnished by a governmental unit to the organization without charge (not including the value of services or facilities generally furnished the public without charge)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7 Other income (not including gain or loss from sale of capital assets) (attach schedule)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8 Total (add lines 1 through 7)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9 Gross receipts from admissions, sales of merchandise or services, or furnishing of facilities in any activity that is not an unrelated business within the meaning of section 513</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10 Total (add lines 8 and 9)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11 Gain or loss from sale of capital assets (attach schedule)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12 Unusual grants</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13 Total revenue (add lines 10 through 12)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>14 Fundraising expenses</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15 Contributions, gifts, grants, and similar amounts paid (attach schedule)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>16 Disbursements to or for benefit of members (attach schedule)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>17 Compensation of officers, directors, and trustees (attach schedule)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>18 Other salaries and wages</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>19 Interest</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>20 Occupancy (rent, utilities, etc.)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>21 Depreciation and depletion</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>22 Other (attach schedule)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>23 Total expenses (add lines 14 through 22)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>24 Excess of revenue over expenses</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(line 13 minus line 23)</td>
</tr>
</tbody>
</table>
## B. Balance Sheet (at the end of the period shown)

<table>
<thead>
<tr>
<th>Assets</th>
<th>Current tax year Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>1</td>
</tr>
<tr>
<td>Accounts receivable, net</td>
<td>2</td>
</tr>
<tr>
<td>Inventories</td>
<td>3</td>
</tr>
<tr>
<td>Bonds and notes receivable (attach schedule)</td>
<td>4</td>
</tr>
<tr>
<td>Corporate stocks (attach schedule)</td>
<td>5</td>
</tr>
<tr>
<td>Mortgage loans (attach schedule)</td>
<td>6</td>
</tr>
<tr>
<td>Other investments (attach schedule)</td>
<td>7</td>
</tr>
<tr>
<td>Depreciable and depletable assets (attach schedule)</td>
<td>8</td>
</tr>
<tr>
<td>Land</td>
<td>9</td>
</tr>
<tr>
<td>Other assets (attach schedule)</td>
<td>10</td>
</tr>
<tr>
<td>Total assets (add lines 1 through 10)</td>
<td>11</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liabilities</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts payable</td>
<td>12</td>
</tr>
<tr>
<td>Contributions, gifts, grants, etc., payable</td>
<td>13</td>
</tr>
<tr>
<td>Mortgages and notes payable (attach schedule)</td>
<td>14</td>
</tr>
<tr>
<td>Other liabilities (attach schedule)</td>
<td>15</td>
</tr>
<tr>
<td>Total liabilities (add lines 12 through 15)</td>
<td>16</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Fund Balances or Net Assets</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total fund balances or net assets</td>
<td>17</td>
</tr>
<tr>
<td>Total liabilities and fund balances or net assets (add line 16 and line 17)</td>
<td>18</td>
</tr>
</tbody>
</table>

If there has been any substantial change in any aspect of the organization's financial activities since the end of the period shown above, check the box and attach a detailed explanation. 

[ ]
Schedule A. Churches

1. Provide a brief history of the development of the organization, including the reasons for its formation.

2. Does the organization have a written creed or statement of faith? □ Yes □ No

3. Does the organization require prospective members to renounce other religious beliefs or their membership in other churches or religious orders to become members? □ Yes □ No

4. Does the organization have a formal code of doctrine and discipline for its members? □ Yes □ No

5. Describe the form of worship and attach a schedule of worship services.

6. Are the services open to the public? □ Yes □ No

7. Explain how the organization attracts new members.

8. (a) How many active members are currently enrolled in the church?

(b) What is the average attendance at the worship services?

9. In addition to worship services, what other religious services (such as baptisms, weddings, funerals, etc.) does the organization conduct?
Schedule A. Churches (Continued)

<table>
<thead>
<tr>
<th></th>
<th>Question</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>10</td>
<td>Does the organization have a school for the religious instruction of the young?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Were the current deacons, minister, and pastor formally ordained after a prescribed course of study?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>Describe the organization's religious hierarchy or ecclesiastical government.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>13</td>
<td>Does the organization have an established place of worship?</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>If &quot;Yes,&quot; provide the name and address of the owner or lessor of the property and the address and a description of the facility.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>If the organization has no regular place of worship, state where the services are held and how the site is selected.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>Does (or will) the organization license or otherwise ordain ministers (or their equivalent) or issue church charters?</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>If &quot;Yes,&quot; describe in detail the requirements and qualifications needed to be so licensed, ordained, or chartered.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>Did the organization pay a fee for a church charter?</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>If &quot;Yes,&quot; state the name and address of the organization to which the fee was paid, attach a copy of the charter, and describe the circumstances surrounding the chartering.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>16</td>
<td>Show how many hours a week the minister/pastor and officers each devote to church work and the amount of compensation paid to each of them. If the minister or pastor is otherwise employed, indicate by whom employed, the nature of the employment, and the hours devoted to that employment.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Schedule A. Churches (Continued)

17 Will any funds or property of the organization be used by any officer, director, employee, minister, or pastor for his or her personal needs or convenience?  

- Yes  
- No  

If "Yes," describe the nature and circumstances of such use.

18 List any officers, directors, or trustees related by blood or marriage.

19 Give the name of anyone who has assigned income to the organization or made substantial contributions of money or other property. Specify the amounts involved.

Instructions

Although a church, its integrated auxiliaries, or a convention or association of churches is not required to file Form 1023 to be exempt from Federal income tax or to receive tax deductible contributions, such an organization may find it advantageous to obtain recognition of exemption. In this event, you should submit information showing that your organization is a church, synagogue, association or convention of churches, religious order or religious organization that is an integral part of a church, and that it is carrying out the functions of a church.

In determining whether an admittedly religious organization is also a church, the IRS does not accept any and every assertion that such an organization is a church. Because beliefs and practices vary so widely, there is no single definition of the word "church" for tax purposes. The IRS considers the facts and circumstances of each organization applying for church status.

The IRS maintains two basic guidelines in determining that an organization meets the religious purposes test:

1. That the particular religious beliefs of the organization are truly and sincerely held, and

2. That the practices and rituals associated with the organization's religious beliefs or creed are not illegal or contrary to clearly defined public policy.

In order for the IRS to properly evaluate your organization's activities and religious purposes, it is important that all questions in this schedule are answered accurately.

The information submitted with this schedule will be a determining factor in granting the "church" status requested by your organization. In completing the schedule, consider the following points:

1. The organization's activities in furtherance of its beliefs must be exclusively religious, and

2. An organization will not qualify for exemption if it has a substantial nonexempt purpose of serving the private interests of its founder or the founder's family.
### Schedule B - Schools, Colleges, and Universities

1. **Does the organization normally have:**
   - (a) a regularly scheduled curriculum, (b) a regular faculty of qualified teachers, (c) a regularly enrolled student body, and (d) facilities where its educational activities are regularly carried on?  
   - **Yes** ☐  **No** ☐  
   - If "No," do not complete the rest of this Schedule.

2. **Is the organization an instrumentality of a state or political subdivision of a state?**  
   - **Yes** ☐  **No** ☐  
   - If "Yes," document this in Part II and do not complete items 3 through 10 of this schedule. (See instructions for Schedule B.)

3. **Does or will the organization (or any department or division within it) discriminate in any way on the basis of race with respect to:**
   - (a) Admissions?  
   - **Yes** ☐  **No** ☐  
   - (b) Use of facilities or exercise of student privileges?  
   - **Yes** ☐  **No** ☐  
   - (c) Faculty or administrative staff?  
   - **Yes** ☐  **No** ☐  
   - (d) Scholarship or loan programs?  
   - **Yes** ☐  **No** ☐  
   - If "Yes," for any of the above, explain.

4. **Does the organization include a statement in its charter, bylaws, or other governing instrument, or in a resolution of its governing body, that it has a racially nondiscriminatory policy as to students?**  
   - **Yes** ☐  **No** ☐  
   - **If applicable, attach whatever corporate resolutions or other official statements the organization has made on this subject.**

5a. **Has the organization made its racially nondiscriminatory policies known in a manner that brings the policies to the attention of all segments of the general community that it serves?**  
   - **Yes** ☐  **No** ☐  
   - If "Yes," describe how these policies have been publicized and how often relevant notices or announcements have been made. If no newspaper or broadcast media notices have been used, explain.

   - **b** If applicable, attach clippings of any relevant newspaper notices or advertising, or copies of tapes or scripts used for media broadcasts. Also attach copies of brochures and catalogues dealing with student admissions, programs, and scholarships, as well as representative copies of all written advertising used as a means of informing prospective students of the organization's programs.

6. **Attach a numerical schedule showing the racial composition, as of the current academic year, and projected to the extent feasible for the next academic year, of (a) the student body, and (b) the faculty and administrative staff.**

7. **Attach a list showing the amount of any scholarship and loan funds awarded to students enrolled and the racial composition of the students who have received the awards.**

8a. **Attach a list of the organization's incorporators, founders, board members, and donors of land or buildings, whether individuals or organizations.**

8b. **State whether any of the organizations listed in 8a have as an objective the maintenance of segregated public or private school education, and, if so, whether any of the individuals listed in 8a are officers or active members of such organizations.**

9a. **Indicate the public school district and county in which the organization is located.**

   - **b** Was the organization formed or substantially expanded at the time of public school desegregation in the above district or county?  
   - **Yes** ☐  **No** ☐

10. **Has the organization ever been determined by a state or Federal administrative agency or judicial body to be racially discriminatory?**  
   - **Yes** ☐  **No** ☐  
   - If "Yes," attach a detailed explanation identifying the parties to the suit, the forum in which the case was heard, the cause of action, the holding in the case, and the citations (if any) for the case. Also describe in detail what changes in the organization's operation, if any, have occurred since then.

   - **For more Information, see instructions.**
Schedule C. Hospitals and Medical Research Organizations

Check here if claiming to be a hospital; complete the questions in section I of this schedule; and write "N/A" in Section II.

Check here if claiming to be a medical research organization operated in conjunction with a hospital; complete the questions in Section II of this Schedule; and write "N/A" in Section I.

Section I  Hospitals

1a  How many doctors are on the hospital's courtesy staff? ................................................................. [ ] Yes  [ ] No

b  Are all the doctors in the community eligible for staff privileges? .......................................................... [ ] Yes  [ ] No

If "No," give the reasons why and explain how the courtesy staff is selected.

2a  Does the hospital maintain a full-time emergency room? ................................................................. [ ] Yes  [ ] No

b  What is the hospital's policy on administering emergency services to persons without apparent means to pay?

c  Does the hospital have any arrangements with police, fire, and voluntary ambulance services for the delivery
or admission of emergency cases? ................................................................. [ ] Yes  [ ] No

Explain.

3a  Does or will the hospital require a deposit from persons covered by Medicare or Medicaid in its admission
practices? ................................................................. [ ] Yes  [ ] No

If "Yes," explain.

b  Does the same deposit requirement, if any, apply to all other patients? ................................................................. [ ] Yes  [ ] No

If "No," explain.

4  Does or will the hospital provide for a portion of its services and facilities to be used for charity patients?  ................................................................. [ ] Yes  [ ] No

Explain the policy regarding charity cases. Include data on the hospital's past experience in admitting charity patients
and arrangements it may have with municipal or government agencies for absorbing the cost of such care.

5  Does or will the hospital carry on a formal program of medical training and research? ................................................................. [ ] Yes  [ ] No

If "Yes," describe.

6  Does the hospital provide office space to physicians carrying on a medical practice? ................................................................. [ ] Yes  [ ] No

If "Yes," attach a list setting forth the name of each physician, the amount of space provided, the annual rent, the
expiration date of the current lease and whether the terms of the lease represent fair market value.

Section II  Medical Research Organizations

1  Name the hospitals with which the organization has a relationship and describe the relationship.

2  Attach a schedule describing the organization's present and proposed (indicate which) medical research activities; show the nature of the
activities, and the amount of money that has been or will be spent in carrying them out. (Making grants to other organizations is not direct
conduct of medical research.)

3  Attach a statement of assets showing their fair market value and the portion of the assets directly devoted to medical research.

For more information, see instructions.
## Schedule D. Section 509(a)(3) Supporting Organization

### 1. Organizations supported by the applicant organization:

<table>
<thead>
<tr>
<th>Name and address of supported organization</th>
<th>b Has the supported organization received a ruling or determination letter that it is not a private foundation by reason of section 509(a)(1) or (2)?</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>Yes</td>
</tr>
</tbody>
</table>

- c If "No" for any of the organizations listed in 1a, explain.

### 2. Does the supported organization have tax-exempt status under section 501(c)(4), 501(c)(5), or 501(c)(6)?

- Yes | No
- Yes | No
- Yes | No
- Yes | No
- Yes | No

If "Yes," attach: (a) a copy of its ruling or determination letter, and (b) an analysis of its revenue for the current year and the preceding 3 years. (Provide the financial data using the formats in Part IV-A (lines 1–13) and Part III (lines 12, 13, and 14).)

### 3. Does your organization's governing document indicate that the majority of its governing board is elected or appointed by the supported organizations? 

- Yes | No

If "Yes," skip to line 8.

If "No," you must answer the questions on lines 4 through 9.

### 4. Does your organization's governing document indicate the common supervision or control that it and the supported organizations share? 

- Yes | No

If "Yes," give the article and paragraph numbers. If "No," explain.

### 5. To what extent do the supported organizations have a significant voice in your organization's investment policies, in the making and timing of grants, and in otherwise directing the use of your organization's income or assets?

### 6. Does the mentioning of the supported organizations in your organization's governing instrument make it a trust that the supported organizations can enforce under state law and compel to make an accounting? 

- Yes | No

If "Yes," explain.

### 7. a What percentage of your organization's income does it pay to each supported organization?

### 7. b What is the total annual income of each supported organization?

### 7. c How much does your organization contribute annually to each supported organization?

---

For more information, see instructions.
**Schedule D. Section 509(a)(3) Supporting Organization (Continued)**

8. To what extent does your organization conduct activities that would otherwise be carried on by the supported organizations? Explain why these activities would otherwise be carried on by the supported organizations.

9. Is the applicant organization controlled directly or indirectly by one or more "disqualified persons" (other than one who is a disqualified person solely because he or she is a manager) or by an organization that is not described in section 509(a)(1) or (2)?

   - [ ] Yes
   - [ ] No

   If "Yes," explain.

---

**Instructions**

For an explanation of the types of organizations defined in section 509(a)(3) as being excluded from the definition of a private foundation, see Pub. 557, Chapter 3.

**Line 1**

List each organization that is supported by your organization and indicate in item 1b if the supported organization has received a letter recognizing exempt status as a section 501(c)(3) public charity as defined in section 509(a)(1) or 509(a)(2). If you answer "No" in 1b to any of the listed organizations, please explain in 1c.

**Line 3**

Your organization's governing document may be articles of incorporation, articles of association, constitution, trust indenture, or trust agreement.

**Line 9**

For a definition of a "disqualified person," see Specific Instructions, Part II, line 4d, on page 3 of the application's instructions.

For Paperwork Reduction Act Notice, see instr. CS1

Form 1023 (Rev. 7-93)
### Schedule E. Private Operating Foundation

<table>
<thead>
<tr>
<th>Income Test</th>
<th>Most recent tax year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1a Adjusted net income, as defined in Regulations section 53.4942(a)-2(d)</td>
<td>1a</td>
</tr>
<tr>
<td>1b Minimum investment return, as defined in Regulations section 53.4942(a)-2(d)</td>
<td>1b</td>
</tr>
<tr>
<td>2 Qualifying distributions:</td>
<td>2a</td>
</tr>
<tr>
<td>a Amounts (including administrative expenses) paid directly for the active conduct of the activities for which organized and operated under section 501(c)(3) (attach schedule)</td>
<td>2a</td>
</tr>
<tr>
<td>b Amounts paid to acquire assets to be used (or held for use) directly in carrying out purposes described in section 170(c)(1) or 170(c)(2)(B) (attach schedule)</td>
<td>2b</td>
</tr>
<tr>
<td>c Amounts set aside for specific projects that are for purposes described in section 170(c)(1) or 170(c)(2)(B) (attach schedule)</td>
<td>2c</td>
</tr>
<tr>
<td>d Total qualifying distributions (add lines 2a, b, and c)</td>
<td>2d</td>
</tr>
<tr>
<td>3 Percentages:</td>
<td>3a</td>
</tr>
<tr>
<td>a Percentage of qualifying distributions to adjusted net income (divide line 2d by line 1a)</td>
<td>3a</td>
</tr>
<tr>
<td>b Percentage of qualifying distributions to minimum investment return (divide line 2d by line 1b)</td>
<td>3b</td>
</tr>
<tr>
<td>(Percentage must be at least 85% for 3a or 3b)</td>
<td>3b</td>
</tr>
</tbody>
</table>

#### Assets Test

| |
|------------------|------------------|
| 4 Value of organization's assets used in activities that directly carry out the exempt purposes. Do not include assets held merely for investment or production of income (attach schedule) | 4 |
| 5 Value of any stock of a corporation that is controlled by applicant organization and carries out its exempt purposes (attach statement describing corporation) | 5 |
| 6 Value of all qualifying assets (add lines 4 and 5) | 6 |
| 7 Value of applicant organization's total assets | 7 |
| 8 Percentage of qualifying assets to total assets (divide line 6 by line 7 – percentage must exceed 50%) | 8 |

#### Support Test

| 9 Value of assets not used (or held for use) directly in carrying out exempt purposes: | 9 |
| a Monthly average of investment securities at fair market value | 9a |
| b Monthly average of cash balances | 9b |
| c Fair market value of all other investment property (attach schedule) | 9c |
| d Total (add lines 9a, b, and c) | 9d |
| 10 Acquisition indebtedness related to line 9 items (attach schedule) | 10 |
| 11 Balance (subtract line 10 from line 9d) | 11 |
| 12 Add: line 11 by 3.13% (2/3 of the percentage for the minimum investment return computation under section 4942(a)). Line 2d above must equal or exceed the result of this computation | 12 |

#### Endowment Test

| 13 Applicant organization’s support as defined in section 509(d) | 13 |
| 14 Gross investment income as defined in section 509(e) | 14 |
| 15 Support for purposes of section 4942(a)(3)(B)(iii) (subtract line 14 from line 13) | 15 |
| 16 Support received from the general public, five or more exempt organizations, or a combination of these sources (attach schedule) | 16 |
| 17 For persons (other than exempt organizations) contributing more than 1% of line 15, enter the total amounts that are more than 1% of line 15 | 17 |
| 18 Subtract line 17 from line 16 | 18 |
| 19 Percentage of total support (divide line 18 by line 15 – must be at least 85%) | 19 |
| 20 Does line 16 include support from an exempt organization that is more than 25% of the amount of line 15? | Yes No |
| 21 Newly created organizations with less than 1 year’s experience: Attach a statement explaining how the organization is planning to satisfy the requirements of section 4942(a)(6) for the income test and one of the supplemental tests during its first year’s operation. Include a description of plans and arrangements, press clippings, public announcements, solicitations for funds, etc. | |
| 22 Does the amount entered on line 2a include any grants that the applicant organization made? | Yes No |

If "Yes," attach a statement explaining how those grants satisfy the criteria for "significant involvement" as defined in section 53.4942(b)-1(b)(2) of the regulations.

For more information, see instructions.
## Schedule F. Homes for the Aged or Handicapped

1. **What are the requirements for admission to residency? Explain fully and attach promotional literature and application forms.**

2. **Does or will the home charge an entrance or founder’s fee?**
   - Yes [ ]
   - No [ ]
   - If “Yes,” explain and specify the amount charged.

3. **What periodic fees or maintenance charges are or will be required of its residents?**

4a. **What established policy does the home have concerning residents who become unable to pay their regular charges?**

4b. **What arrangements does the home have or will it make with local and Federal welfare units, sponsoring organizations, or others to absorb all or part of the cost of maintaining those residents?**

5. **What arrangements does or will the home have to provide for the health needs of its residents?**

6. **In what way are the home’s residential facilities designed to meet some combination of the physical, emotional, recreational, social, religious, and similar needs of the aged or handicapped?**

7. **Provide a description of the home’s facilities and specify both the residential capacity of the home and the current number of residents.**

8. **Attach a sample copy of the contract or agreement the organization makes with or requires of its residents.**
Schedule G. Child Care Organizations

1. Is the organization's primary activity the providing of care for children away from their homes? □ Yes □ No

2. How many children is the organization authorized to care for by the state (or local governmental unit), and what was the average attendance during the past 6 months, or the number of months the organization has been in existence if less than 6 months?

3. How many children are currently cared for by the organization?

4. Is substantially all (at least 85%) of the care provided for the purpose of enabling parents to be gainfully employed or to seek employment? □ Yes □ No

5. Are the services provided available to the general public? □ Yes □ No
   If "No," explain.

6. Indicate the category, or categories, of parents whose children are eligible for the child-care services (check as many as apply):
   - Low income parents
   - Any working parents (or parents looking for work)
   - Anyone with the ability to pay
   - Other (explain)

Instructions

Line 5
If your organization's services are not available to the general public, indicate the particular group or groups that may utilize your services. REMINDER - If this organization claims to operate a school, then it must also fill out Schedule B.
### Schedule H. Organizations Providing Scholarship Benefits, Student Aid, Etc., to Individuals

1. Describe the nature and the amount of the scholarship benefit, student aid, etc., including the terms and conditions governing its use, whether a gift or a loan, and how the availability of the scholarship is publicized. If the organization has established or will establish several categories of scholarship benefits, identify each kind of benefit and explain how the organization determines the recipients for each category. Attach a sample copy of any application the organization requires individuals to complete to be considered for scholarship grants, loans, or similar benefits. (Private foundations that make grants for travel, study, or other similar purposes are required to obtain advance approval of scholarship procedures. See Regulations sections 53.4945-4(c) and (d).)

   - [ ] If you want this application considered as a request for approval of grant procedures in the event we determine that the organization is a private foundation, check here. 

2. If you checked the box in 1b above, indicate the sections for which you wish the organization to be considered.

   - 4945(g)(1)
   - 4945(g)(2)
   - 4945(g)(3)

3. What limitations or restrictions are there on the class of individuals who are eligible recipients? Specifically explain whether there are, or will be, any restrictions or limitations in the selection procedures based upon race or the employment status of the prospective recipient or any relative of the prospective recipient. Also indicate the approximate number of eligible individuals.

4. If the organization bases its selections in any way on the employment status of the applicant or any relative of the applicant, indicate whether there is or has been any direct or indirect relationship between the members of the selection committee and the employer. Also indicate whether relatives of the members of the selection committee are possible recipients or have been recipients.

5. Describe any procedures the organization has for supervising grants (such as obtaining reports or transcripts) that its awards, and any procedures it has for taking action if the terms of the grant are violated.
Schedule I. Successors to "For Profit" Institutions

1. What was the name of the predecessor organization and the nature of its activities?

2. Who were the owners or principal stockholders of the predecessor organization? (If more space is needed, attach schedule.)

<table>
<thead>
<tr>
<th>Name and address</th>
<th>Share or Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
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<td></td>
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<td></td>
</tr>
</tbody>
</table>

3. Describe the business or family relationship between the owners or principal stockholders and principal employees of the predecessor organization and the officers, directors, and principal employees of the applicant organization.

4a. Attach a copy of the agreement of sale or other contract that sets forth the terms and conditions of sale of the predecessor organization or of its assets to the applicant organization.

b. Attach an appraisal by an independent qualified expert showing the fair market value at the time of sale of the facilities or property interest sold.

5. Has any property or equipment formerly used by the predecessor organization been rented to the applicant organization or will any such property be rented? If "Yes," explain and attach copies of all leases and contracts.

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

6. Is the organization leasing or will it lease or otherwise make available any space or equipment to the owners, principal stockholders, or principal employees of the predecessor organization? If "Yes," explain and attach a list of these tenants and a copy of the lease for each such tenant.

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

7. Were any new operating policies initiated as a result of the transfer of assets from a profit-making organization to a nonprofit organization? If "Yes," explain.

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Additional Information

A "for profit" institution for purposes of this schedule includes any organization in which a person may have a proprietary or partnership interest, hold corporate stock, or otherwise exercise an ownership interest. The institution need not have operated for the purpose of making a profit.
Department of the Treasury
Internal Revenue Service

Instructions for Form 1023
(Revised July 1993)

Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code

(Section references are to the Internal Revenue Code unless otherwise noted.)

Note: Retain a copy of the completed Form 1023 in the organization’s permanent records. See Public Inspection of Form 1023 regarding public inspection of approved applications.

Paperwork Reduction Act Notice. - We ask for the information on this form to carry out the Internal Revenue laws of the United States. If you want your organization to be recognized as tax exempt by the IRS, you are required to give us this information. We need it to determine whether the organization meets the legal requirements for tax-exempt status.

The time needed to complete and file these forms will vary depending on individual circumstances. The estimated average times are:

<table>
<thead>
<tr>
<th>Form</th>
<th>Recordkeeping</th>
<th>Learning about the law</th>
<th>Preparing, and sending the form to IRS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1023 Parts I to IV</td>
<td>55 hr., 14 min.</td>
<td>4 hr., 37 min.</td>
<td>8 hr., 7 min.</td>
</tr>
<tr>
<td>1023 Sch. A</td>
<td>7 hr., 10 min.</td>
<td>0 min.</td>
<td>7 min.</td>
</tr>
<tr>
<td>1023 Sch. B</td>
<td>4 hr., 47 min.</td>
<td>30 min.</td>
<td>36 min.</td>
</tr>
<tr>
<td>1023 Sch. C</td>
<td>5 hr., 1 min.</td>
<td>35 min.</td>
<td>43 min.</td>
</tr>
<tr>
<td>1023 Sch. D</td>
<td>4 hr., 4 min.</td>
<td>42 min.</td>
<td>47 min.</td>
</tr>
<tr>
<td>1023 Sch. E</td>
<td>9 hr., 20 min.</td>
<td>1 hr., 5 min.</td>
<td>1 hr., 17 min.</td>
</tr>
<tr>
<td>1023 Sch. F</td>
<td>2 hr., 39 min.</td>
<td>2 hr., 53 min.</td>
<td>3 hr., 3 min.</td>
</tr>
<tr>
<td>1023 Sch. G</td>
<td>2 hr., 38 min.</td>
<td>0 min.</td>
<td>22 min.</td>
</tr>
<tr>
<td>1023 Sch. H</td>
<td>1 hr., 55 min.</td>
<td>42 min.</td>
<td>46 min.</td>
</tr>
<tr>
<td>1023 Sch. I</td>
<td>3 hr., 35 min.</td>
<td>0 min.</td>
<td>4 min.</td>
</tr>
<tr>
<td>872-C</td>
<td>1 hr., 26 min.</td>
<td>24 min.</td>
<td>26 min.</td>
</tr>
</tbody>
</table>

If you have comments concerning the accuracy of these time estimates or suggestions for making these forms more simple, we would be happy to hear from you. You can write to both the Internal Revenue Service, Attention: Reports Clearance Officer, T:FP, Washington, DC 20224; and the Office of Management and Budget, Paperwork Reduction Project (1549-0056), Washington, DC 20503. DO NOT send the tax form to either of these offices. Instead, see Where To File below.

General instructions

User Fee. - A user fee must be paid with determination letter requests submitted to the Internal Revenue Service. Form 8718, User Fee for Exempt Organization Determination Letter Request, must be submitted with this application along with the appropriate fee as stated on Form 8718. Form 8718 may be obtained through your local IRS office or by calling the telephone
number given below for obtaining forms and publications.

Helpful Information. - For additional information, get Pub. 557, Tax-Exempt Status for Your Organization; Pub. 578, Tax Information for Private Foundations and Foundation Managers; and Pub. 598, Tax on Unrelated Business Income of Exempt Organizations. You may also call 1-800-829-4477; ask for Topics #109 and #110 (a push-button telephone is required). For additional forms and publications, call 1-800-829-3676.

Purpose of Form

1. Completed Form 1023 required for section 501(c)(3) exemption. - Unless it meets either of the exceptions in item 2 below, or notifies the IRS that it is applying for recognition of section 501(c)(3) exempt status, no organization formed after October 9, 1969, will be considered tax exempt under section 501(c)(3).

An organization notifies the IRS by filing a completed Form 1023. Form 1023 also solicits the information that the IRS needs to determine if the organization is a private foundation.

2. Organizations not required to file Form 1023. - The following organizations will be considered tax exempt under section 501(c)(3) even if they do not file Form 1023: (a) churches, their integrated auxiliaries, and conventions or associations of churches, or (b) any organization that is not a private foundation (as defined in section 509(a)) and that has gross receipts in each taxable year of normally not more than $5,000.

Even if these organizations are not required to file Form 1023 to be tax-exempt, they may wish to file Form 1023 and receive a determination letter of IRS recognition of their section 501(c)(3) status to obtain certain incidental benefits such as public recognition of their tax-exempt status; exemption from certain state taxes; advance assurance to donors of deductibility of contributions; exemption from certain Federal excise taxes; nonprofit mailing privileges, etc.

3. Other organizations. - In applying for a determination letter, cooperative service organizations, described in section 501(e) and (f), and child care organizations, described in section 501(k), use Form 1023 and are treated as section 501(c)(3) organizations.

4. Group exemption letter. - Generally, Form 1023 is not used to apply for a group exemption letter. For information on how to apply for a group exemption letter, see Pub. 557.

What To File

All applicants must complete pages 1 through 9 of Form 1023. The following organizations must also complete the schedules indicated:

1. Churches - Schedule A
2. Schools - Schedule B
3. Hospitals and Medical Research - Schedule C
4. Supporting Organizations (509(a)(3)) - Schedule D
5. Private Operating Foundations - Schedule E
6. Homes for the Aged or Handicapped - Schedule F
7. Child Care - Schedule G
8. Scholarship Benefits or Student Aid - Schedule H
9. Organizations that have taken over or will take over a 'for profit' institution - Schedule I.
10. Organizations requesting an advance ruling in Part III, Line 11 - Form 872-C.

Attachments. - State on each attachment that it relates to Form 1023 and identify the applicable part and line item number. Also show on each attachment the organization’s name, address, and employer identification number (EIN). Use 8 1/2" x 11" paper for attachments.

In addition to the required documents and statements, include with the application any additional information citing court decisions, rulings, opinions, etc., that will expedite processing of the application. Generally, attachments in the form of tape recordings are not acceptable unless accompanied by a transcript.

When To File

An organization formed after October 9, 1969, must file Form 1023 to be recognized as an organization described in section 501(c)(3). Generally, if an organization files its application within 15 months after the end of the month in which it was formed, and if the IRS approves the application, the effective date of the organization's section 501(c)(3) status will be the date it was organized.

Generally, if an organization does not file its application (Form 1023) within 15 months after the end of the month in which it was formed, it will not qualify for exempt status during the period before the date of its application. For exceptions and special rules, including automatic extensions in some cases, see Part III of Form 1023.

Where To File

File the completed application, and all information required, with the key district office for the organization's principal place of business or office as listed on page 2. As soon as possible after the complete application is received, you will be advised of the IRS's determination and of the annual returns (if any) that the organization will be required to file.

If the organization is in: Connecticut, Maine, Massachusetts, New Hampshire, New York, Rhode Island, Vermont
Delaware, District of Columbia, Maryland, New Jersey, Pennsylvania, Virginia, any U.S. Possession or foreign country

Send application and fee to:
Internal Revenue Service EP/EO Division P.O. Box 1680, GPO Brooklyn, NY 11202

Internal Revenue Service EP/EO Division P.O. Box 17010
Indiana, Kentucky, Michigan, Ohio, West Virginia
Arizona, Colorado, Kansas, New Mexico, Oklahoma, Texas, Utah, Wyoming
Alabama, Arkansas, Florida, Georgia, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee
Alaska, California, Hawaii, Idaho, Nevada, Oregon, Washington
Illinois, Iowa, Minnesota, Missouri, Montana, Nebraska, North Dakota, South Dakota, Wisconsin
U.S. Virgin Islands

Signature Requirements

An officer, a trustee who is authorized to sign, or another person authorized by a power of attorney must sign this application. Send the power of attorney with the application when you file it. Form 2848, Power of Attorney and Declaration of Representative, or Form 8821, Tax Information Authorization, may be used for this purpose.

Deductibility of Contributions

Deductions for charitable contributions are not allowed for any gifts or bequests made to organizations that do not qualify under section 501(c)(3). The effective date of an organization’s section 501(c)(3) status determines the date that contributions to it are deductible by donors. (See When To File on page 1.)

Public Inspection of Form 1023

IRS responsibilities. - If the application is approved, it and any supporting documents will be open to public inspection, as required by section 6104, in any key district office and in the Internal Revenue Service’s National Office. In addition, any letter or other document issued by the IRS with regard to the
application will be open to public inspection. However, information relating to a trade secret, patent, style of work, or apparatus that, if released, would adversely affect the organization, or any other information that would adversely affect the national defense, will not be made available for public inspection. You must identify this information by clearly marking it 'NOT SUBJECT TO PUBLIC INSPECTION' and attach a statement explaining why the organization asks that the information be withheld. If the IRS agrees, the information will be withheld.

Organization's responsibilities. - The organization must make available for public inspection a copy of its approved application and supporting documents, along with any document or letter issued by the IRS. These must be available during regular business hours at the organization's principal office and at each of its regional or district offices having at least 3 paid employees. See Notice 88-120, 1988-2 C.B. 454. If any person under a duty to comply with the inspection provisions fails to comply with these requirements, a penalty of $10 a day will be imposed for each day the failure continues.

Appeal Procedures

The organization's application will be considered by the key district office, which will either:

1. Issue a favorable determination letter;
2. Issue a proposed adverse determination letter denying the exempt status requested; or
3. Refer the case to the National Office.

If we send you a proposed adverse determination, we will advise you of your appeal rights at that time.

Language and Currency Requirements

Form 1023 and attachments must be prepared in English. If the organizational document or bylaws are in any other language, an English translation must be furnished. If the organization produces or distributes foreign language publications that are submitted with the application, you may be asked to provide English translations for one or more of them during the processing of the application.

Report all financial information in U.S. dollars (specify the conversion rate used). Combine amounts from within and outside the United States and report the total for each item on the financial statements.

For example:

Gross Investment Income
   From U.S. sources $4,000
   From non-U.S. sources 1,000
   Amount to report on income statement $5,000

Annual Information Return

If the annual information return for tax-exempt organizations becomes due while its application for recognition of exempt status is pending with the IRS (including any appeal of a proposed adverse determination), the organization
should file Form 990, Return of Organization Exempt From Income Tax (or Form 990-EZ, Short Form Return of Organization Exempt From Income Tax) and Schedule A (Form 990), Organization Exempt Under Section 501(c)(3), or Form 990-PF, Return of Private Foundation, if a private foundation, and indicate that an application is pending.

Special Rule for Canadian Colleges and Universities

A Canadian college or university that has received a Form T2051, Notification of Registration, from Revenue Canada (Department of National Revenue, Taxation) and whose registration has not been revoked, does not have to complete all parts of Form 1023 that would otherwise be applicable. Such an organization must complete only Part I of Form 1023 and Schedule B (Schools, Colleges, and Universities). The organization must also attach a copy of its Form T2050, Application for Registration, together with all the required attachments that it submitted to Revenue Canada. If any attachments were prepared in French, an English translation must be furnished. Other Canadian organizations seeking a determination of section 501(c)(3) status must complete Form 1023 in the same manner as U.S. organizations.

Specific Instructions

The following instructions are keyed to the line items on the application form:

Part I. Identification of Applicant

Line 1. Full name and address of organization. - Enter the organization’s name exactly as it appears in its creating document including amendments. If the organization will be operating under another name, show the other name in parentheses.

Line 2. Employer identification number (EIN). - All organizations must have an EIN. Enter the 9-digit EIN assigned to the organization by the IRS. If the organization does not have an EIN, get Form SS-4, Application for Employer Identification Number, for details on how to obtain an EIN immediately by telephone. If the organization has previously applied for a number, enter 'applied for' and attach a statement giving the date of the application and the office where it was filed. Do not apply for an EIN more than once.

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Line 3. Person to contact. - Enter the name and telephone number of the person to contact during business hours if more information is needed. The contact person should be an officer, director, or a person with power of attorney who is familiar with the organization’s activities and is authorized to act on its behalf.

Line 4. Month the annual accounting period ends. - Enter the month the organization’s annual accounting period ends. The accounting period is usually the 12-month period that is the organization’s tax year. The organization’s first tax year depends on the accounting period chosen (it could be less than 12 months).

Line 5. Date formed. - Enter the date the organization became a legal entity. For a corporation, this is the date that the articles of incorporation were approved by the appropriate state official. For an unincorporated organization, it is the date its constitution or articles of association were
adopted.

Line 6. Activity codes. - Select up to three of the code numbers listed on the back cover that best describe or most accurately identify the organization's purposes, activities, or type of organization. Enter the codes in the order of importance.

Line 7. - Indicate if the organization is one of the following:

- 501(e) Cooperative hospital service organization;
- 501(f) Cooperative service organization of operating educational organization;
- 501(k) Organization providing child care, if none of the above applies, make no entry on line 7.

Line 8. - Indicate if the organization has ever filed a Form 1023 or Form 1024, Application for Recognition of Exemption Under Section 501(a) or for Determination Under Section 120, with the IRS.

Line 9. - If the organization for which this application is being filed is a private foundation, answer 'NA.' If the organization is not required to file Form 990 (or Form 990-EZ) and is not a private foundation, answer 'No' and attach an explanation. Get the Form 990 Instructions and refer to page 2 for a discussion of organizations not required to file Form 990 (or Form 990-EZ). Otherwise, answer 'Yes.'

Line 10. - Indicate if the organization has ever filed Federal income tax returns as a taxable organization or filed returns as an exempt organization (e.g. Form 990, 990-EZ, 990-PF, or 990-T, Exempt Organization Business Income Tax Return).

Line 11. Type of organization and organizational documents. - Submit a conformed copy of the organizing instrument. A conformed copy is one that agrees with the original and all amendments to it. The conformed copy may be a photocopy of the original signed and dated organizing document OR it may be a copy of the organizing document that is not signed but is accompanied by a written declaration signed by an authorized individual stating that the copy is a complete and accurate copy of the original signed and dated document.

In the case of a corporation, a copy of the articles of incorporation, approved and dated by an appropriate state official, is sufficient by itself. If an unsigned copy of the articles of incorporation is submitted, it must be accompanied by the written declaration discussed above. Signed or unsigned copies of the articles of incorporation must be accompanied by a declaration stating that the original copy of the articles was filed with, and approved by, the state. The date filed must be specified.

In the case of an unincorporated association, the conformed copy of the constitution, articles of association, or other organizing document must indicate in the document itself, or in a written declaration, that the organization was formed by the adoption of the document by two or more persons.

In the case of a trust, a copy of the signed and dated trust instrument must be furnished.
For your organization to qualify for exempt status, its organizing instrument must contain a proper dissolution clause, or state law must provide for distribution of assets for one or more exempt (section 501(c)(3)) purposes upon dissolution. If you rely on state law, please cite the law and briefly state its provisions on an attachment. The organizing instrument must also specify the organizational purposes and the purposes specified must be limited to one or more of those set out in section 501(c)(3).

If the organization does not have an organizing instrument, it will not qualify for exempt status. The bylaws of an organization alone are not an organizing instrument. They are merely the internal rules and regulations of the organization.

See Pub. 557 for detailed instructions and, for sample organizing instruments that satisfy the requirements of section 501(c)(3) and the related regulations.

Part II. Activities and Operational Information

Line 1. - It is important that you report all activities carried on by the organization to enable the IRS to make a proper determination of the organization's exempt status.

Line 2. - If it is anticipated that the organization's principal sources of support will increase or decrease substantially in relation to the organization's total support, attach a statement describing anticipated changes and explaining the basis for the expectation.

Line 3. - For purposes of providing the information requested on line 3, 'fundraising activity' includes the solicitation of contributions and both functionally related activities and unrelated business activities. Include a description of the nature and magnitude of the activities.

Line 4a. - Furnish the mailing addresses of the organization's principal officers, directors, or trustees. Do not give the address of the organization.

Line 4b. - The annual compensation includes salary, bonus, and any other form of payment to the individual for services while employed by the organization.

Line 4c. - Public officials include anyone holding an elected position or anyone appointed to a position by an elected official.

Line 4d. - For purposes of this application, a 'disqualified person' is any person who, if the applicant organization were a private foundation, is:

1. A 'substantial contributor' to the foundation (defined below);
2. A foundation manager;
3. An owner of more than 20% of the total combined voting power of a corporation that is a substantial contributor to the foundation;
4. A 'member of the family' of any person described in 1, 2, or 3 above;
5. A corporation, partnership, or trust in which persons described in 1, 2, 3, or 4 above, hold more than 35% of the combined voting power, the profits interest, or the beneficial interests; and
6. Any other private foundation that is effectively controlled by the same persons who control the first-mentioned private foundation or any other private foundation substantially all of whose contributions were made by the same contributors.

A Substantial contributor is any person who gave a total of more than $5,000 to the organization, and those contributions are more than 2% of all the contributions and bequests received by the organization from the date it was created up to the end of the year the contributions by the substantial contributor were received. A creator of a trust is treated as a substantial contributor regardless of the amount contributed by that person or others.

See Pub. 578 for more information on 'disqualified persons.'

Line 5. - If your organization controls or is controlled by another exempt organization or a taxable organization, answer 'Yes.' Examples of special relationships are common officers and the sharing of office space or employees.

Line 6. - If the organization conducts any financial transactions (either receiving funds or paying out funds), or nonfinancial activities with an exempt organization (other than a 501(c)(3) organization), or with a political organization, answer 'Yes,' and explain.

Line 7. - If the organization must report its income and expense activity to any other organization (tax-exempt or taxable entity), answer 'Yes.'

Line 8. - Examples of assets used to perform an exempt function are: land, building, equipment, and publications. Do not include cash or property producing investment income. If you have no assets used in performing the organization's exempt function, answer 'N/A.'

Line 10a. - Answer 'Yes,' if the organization is managed by another exempt organization, a taxable organization, or an individual.

Line 10b. - If the organization leases property from anyone or leases any of its property to anyone, answer 'Yes.'

Line 11. - A membership organization for purposes of this question is an organization that is composed of individuals or organizations who:

1. Share in the common goal for which the organization was created;
2. Actively participate in achieving the organization's purposes; and
3. Pay dues.

Line 12. - Examples of benefits, services, and products are: meals to homeless people, home for the aged, museum open to the public, and a symphony orchestra giving public performances.

Line 13. - An organization is attempting to influence legislation if it contacts or urges the public to contact members of a legislative body, or if it advocates the adoption or rejection of legislation.

If you answer 'Yes,' you may want to file Form 5768, Election/Revocation of
Election by an Eligible Section 501(c)(3) Organization to Make Expenditures to Influence Legislation.

Line 14. - An organization is intervening in a political campaign if it promotes or opposes the candidacy or prospective candidacy of an individual for public office.

Part III. Technical Requirements

Line 1. - If you check 'Yes,' proceed to line 8. If you check 'No,' proceed to line 2.

Line 2a. - Do not check the box on line 2a if the organization's principal activity is educational, literary, charitable, or of another nature (other than religious) that would serve as a basis for exemption under section 501(c)(3). See Regulations sections 1.508-1(a)(3) and 1.6033-2(g)(5).

Line 3. - Relief from the 15-month filing requirement is granted automatically if the organization submits a completed Form 1023 within 12 months from the end of the 15-month period.


Line 5. - The reasons for late filing should be specific to your particular organization and situation. Revenue Procedure 92-85 lists the factors the IRS will consider in determining if good cause exists for granting an extension of time to file the application. (Also see Pub. 557.) To address these factors, your response on line 5 should provide the following information:

1. Whether the organization consulted an attorney or accountant knowledgeable in tax matters or communicated with a responsible IRS employee (before or after the organization was created) to ascertain the organization’s Federal filing requirements and, if so, the names and occupations or titles of the persons contacted, the approximate dates, and the substance of the information obtained;

2. How and when the organization learned about the 15-month deadline for filing Form 1023;

3. Whether any significant intervening circumstances beyond the organization’s control prevented it from submitting the application timely or within a reasonable period of time after it learned of the requirement to file the application within the 15-month period; and

4. Any other information that you believe may establish good cause for not filing timely or otherwise justify granting the relief sought.

Line 7. - The organization may still be able to qualify for exemption under section 501(c)(4) for the period preceding the effective date of its exemption as a section 501(c)(3) organization. If the organization is qualified under section 501(c)(4) and page 1 of Form 1024 is filed as directed, the organization will not be liable for income tax returns as a taxable entity. Contributions to section 501(c)(4) organizations are generally not deductible by donors as charitable contributions.

Line 8. - Private foundations are subject to various requirements, restrictions, and excise taxes under Chapter 42 of the Internal Revenue Code.
that do not apply to public charities. Also, contributions to private foundations may receive less favorable treatment than contributions to public charities. (See Pub. 578.) Therefore, it is usually to an organization’s advantage to show that it qualifies as a public charity rather than as a private foundation if its activities or sources of support permit it to do so. Unless an organization meets one of the exceptions below, it is a private foundation. In general, an organization is not a private foundation if it is:

1. A church, school, hospital, or governmental unit;
2. A medical research organization operated in conjunction with a hospital;
3. An organization operated for the benefit of a college or university that is owned or operated by a governmental unit;
4. An organization that normally receives a substantial part of its support in the form of contributions from a governmental unit or from the general public as provided in section 170(b)(1)(A)(vi);
5. An organization that normally receives not more than one-third of its support from gross investment income and more than one-third of its support from contributions, membership fees, and gross receipts related to its exempt functions (subject to certain exceptions) as provided in section 509(a)(2);
6. An organization operated solely for the benefit of, and in connection with, one or more organizations described above (or for the benefit of one or more of the organizations described in section 501(c)(4), (5), or (6) of the Code and also described in 5 above), but not controlled by disqualified persons other than foundation managers, as provided in section 509(a)(3); or
7. An organization organized and operated to test for public safety as provided in section 509(a)(4).

Line 9. - Basis for private operating foundation status: (Complete this line only if you answered ‘Yes’ to the question on line 8.)

A ‘private operating foundation’ is a private foundation that spends substantially all of its adjusted net income or its minimum investment return, whichever is less, directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated. The foundation must satisfy the income test and one of the three supplemental tests: (1) the assets test; (2) the endowment test; or (3) the support test. (For additional information, see Pub. 578.)

Line 10. - Basis for nonprivate foundation status: Check the box that shows why your organization is not a private foundation.

Box (a). A church or convention or association of churches.
Box (b). A school - See the definition in the instructions for Schedule B.
Box (c). A hospital or medical research organization. - See the instructions for Schedule C.
Box (d). A governmental unit. - This category includes a state, a possession of the United States, or a political subdivision of any of the foregoing, or the United States, or the District of Columbia.
Box (e). Organizations operated in connection with or solely for organizations described in (a) through (d) or (g), (h), and (i). - The organization must be organized and operated for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in section 509(a)(1) or (2). It must be operated, supervised, or controlled by or in connection with one or more of the organizations described in the instructions for boxes (a) through (d) or (g), (h), and (i). It must not be controlled directly or indirectly by disqualified persons (other than foundation managers or organizations described in section 509(a)(1) or (2)). To show whether the organization satisfies these tests, complete Schedule D.

Box (f). An organization testing for public safety. - An organization in this category is one that tests products to determine their acceptability for use by the general public.

It does not include any organization testing for the benefit of a manufacturer as an operation or control in the manufacture of its product.

Box (g). Organization for the benefit of a college or university owned or operated by a governmental unit. - The organization must be organized and operated exclusively for the benefit of a college or university that is an educational organization within the meaning of section 170(b)(1)(A)(ii) and is an agency or instrumentality of a state or political subdivision of a state; is owned or operated by a state or political subdivision of a state; or is owned or operated by an agency or instrumentality of one or more states or political subdivisions. The organization must also normally receive a substantial part of its support from the United States or any state or political subdivision of a state, or from direct or indirect contributions from the general public or from a combination of these sources. An organization described in section 170(b)(1)(A)(iv) will be subject to the same publicly supported rules that are applicable to 170(b)(1)(A)(vi) organizations described in box (h) below.

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described in section 170(b)(1)(A)(iv) will be subject to the same publicly supported rules that are applicable to 170(b)(1)(A)(vi) organizations described in box (h) below.

Box (h). Organization receiving support from a governmental unit or from the general public. - The organization must receive a substantial part of its support from the United States or any state or political subdivision, or from direct or indirect contributions from the general public or from a combination of these sources. The organization may satisfy the support requirement in either of two ways. It will be treated as publicly supported if the support it normally receives from the above-described governmental units and the general public equals at least one-third of its total support. It will also be treated as publicly supported if the support it normally receives from governmental or public sources equals at least 10% of total support and the organization is set up to attract new and additional public or governmental support on a continuous basis. If the organization’s governmental and public support is at least 10%, but not over one-third of its total support, the questions on lines 1 through 14 of Part II will apply to determine both the organization’s claim of exemption and whether it is publicly supported. Preparers should exercise care to assure that those questions are answered in detail.

Box (i). Organization described in section 509(a)(2). - The organization must satisfy the support test under section 509(a)(2)(A) and the gross investment income test under section 509(a)(2)(B). To satisfy the support test, the organization must normally receive more than one-third of its support from:
(a) gifts, grants, contributions, or membership fees, and (b) gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in an activity that is not an unrelated trade or business (subject to certain limitations discussed below). This one-third of support must be from organizations described in section 509(a)(1), governmental sources, or persons other than disqualified persons. In computing gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities in an activity that is not an unrelated trade or business, the gross receipts from any one person or from any bureau or similar agency of a governmental unit are includible only to the extent they do not exceed the greater of $5,000 or 1% of the organization’s total support. To satisfy the gross investment income test, the organization must not receive more than one-third of its support from gross investment income.

Box (j). - If you believe the organization meets the public support test of section 170(b)(1)(A)(vi) or 509(a)(2) but are uncertain as to which public support test it satisfies, check box (j). By checking this box, you are claiming that the organization is not a private foundation and are agreeing to let the IRS compute the public support of your organization and determine the correct foundation status.

Line 11. - To receive a definitive (final) ruling under sections 170(b)(1)(A)(vi) and 509(a)(1) or under section 509(a)(2), an organization must have completed a tax year consisting of at least 8 months. Organizations that checked box (h), (i), or (j) on line 10 that do not satisfy the 8-month requirement must request an advance ruling covering their first 5 tax years instead of a definitive ruling.

An organization that satisfies the 8-month requirement has two options:

1. It may request a definitive ruling. In this event, the organization’s qualification under sections 170(b)(1)(A)(vi) and 509(a)(1) or under section 509(a)(2) will be based on the support that the organization has received to date; or

2. It may request an advance ruling. If the IRS issues the advance ruling, the organization’s public support computation will be based on the support it receives during its first 5 tax years. An organization should consider this option if it has not received significant public support during its first tax year or during its first and second tax years, but it reasonably expects to receive such support by the end of its fifth tax year. An organization that receives an advance ruling is treated, during the 5-year advance ruling period, as a public charity (rather than a private foundation) for certain purposes, including those relating to the deductibility of contributions by the general public.

Line 12. - For definition of an unusual grant, see instructions for Part IV-A, line 12.

Line 13. - Answer this question only if you checked box (g) or (h) on line 10.

Line 14 - Answer the question on this line only if you checked box (i) on line 10 and are requesting a definitive ruling on line 11.

Line 15. - Answer ‘Yes’ or ‘No’ on each line. If ‘Yes,’ you must complete the appropriate schedule. Each schedule is included in this application package with accompanying instructions. For a brief definition of each type of organization, see the appropriate schedule.
Part IV. Financial Data

The Statement of Revenue and Expenses must be completed for the current year and any of the 3 years immediately before it (or the years the organization has existed, if less than 4). Any applicant that has existed for less than 1 year must give financial data for the current year and proposed budgets for the following 2 years. We may request financial data for more than 4 years if necessary. All financial information for the current year must cover the period beginning on the first day of the organization's established annual accounting period and ending on any day that is within 60 days of the date of this application. If the date of this application is less than 60 days after the first day of the current accounting period, no financial information is required for the current year. Financial information is required for the 3 preceding years regardless of the current year requirements. Please note that if no financial information is required for the current year, the preceding year's financial information can end on any day that is within 60 days of the date of this application. Prepare the statements using the method of accounting the organization uses in keeping its books and records. If the organization uses a method other than the cash receipts and disbursements method, attach a statement explaining the method used.

Statement of Revenue and Expenses

Line 1. - Do not include amounts received from the general public or a governmental unit for the exercise or performance of the organization's exempt function. However, payments made by a governmental unit to enable the organization to provide a service to the general public should be included. Also, do not include unusual grants. (For an explanation of unusual grants, see Line 12 below.)

Line 2. - Include amounts received from members for the basic purpose of providing support to the organization. Do not include payments to purchase admissions, merchandise, services, or use of facilities.

Line 3. - Include on this line the income received from dividends, interest, and payments received on securities loans, rents, and royalties.

Line 4. - Enter the organization's net income from any activities that are regularly carried on and are not related to the organization's exempt purposes. Examples of such income include fees from the commercial testing of products; income from renting office equipment or other personal property; and income from the sale of advertising in an exempt organization's periodical. See Pub. 598 for information about unrelated business income and activities.

Line 5. - Enter the amount collected by the local tax authority from the general public that has been allocated for your organization.

Line 6. - To report the value of services and/or facilities furnished by a governmental unit, use the fair market value at the time the service/facility was furnished to your organization. Do not include any other donated services or facilities in Part IV.

Line 7. - Enter the total income from all sources that is not reported on lines 1 through 6, or lines 9, 11, and 12. Attach a schedule that lists each type of revenue source and the amount derived from each.

Line 9. - Include income generated by the organization's exempt function
activities (charitable, educational, etc.) and by its nontaxable fundraising
events (excluding any contributions received). Examples of such income include
the income derived by a symphony orchestra from the sale of tickets to its
performances; and raffles, bingo, or other fundraising-event income that is
not taxable as unrelated business income because the income-producing
activities are not regularly carried on or because they are conducted with
substantially all (at least 85%) volunteer labor.

Line 11. - Attach a schedule that shows a description of each asset, the name
of the person to whom sold, and the amount received. In the case of publicly
traded securities sold through a broker, the name of the purchaser is not
required.

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Line 12. - Unusual grants generally consist of substantial contributions and
bequests from disinterested persons that:

1. Are attracted by reason of the publicly supported nature of the
organization;

2. Are unusual and unexpected as to the amount; and

3. Would, by reason of their size, adversely affect the status of the
organization as normally meeting the support test of section 170(b)(1)(A)(vi)
or section 509(a)(2), as the case may be.

If the organization is awarded an unusual grant and the terms of the granting
instrument provide that the organization will receive the funds over a period
of years, the amount received by the organization each year under the grant
may be excluded. See the regulations under sections 170 and 509.

Line 14. - Fundraising expenses represent the total expenses incurred in
soliciting contributions, gifts, grants, etc.

Line 15. - Attach a schedule showing the name of the recipient, a brief
description of the purposes or conditions of payment, and the amount paid. The
following example shows the format and amount of detail required for this
schedule:

<table>
<thead>
<tr>
<th>Recipient</th>
<th>Purpose</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Museum of Natural History</td>
<td>General operating budget</td>
<td>$9,000</td>
</tr>
<tr>
<td>State University</td>
<td>Books for needy students</td>
<td>4,500</td>
</tr>
<tr>
<td>Richard Roe</td>
<td>Educational scholarship</td>
<td>2,200</td>
</tr>
</tbody>
</table>

Line 16. - Attach a schedule showing the name of each recipient, a brief
description of the purposes or condition of payment, and amount paid. Do not
include any amounts that are on line 15. The schedule should be similar to the
schedule shown in the line 15 instructions above.

Line 17. - Attach a schedule that shows the name of the person compensated;
the office or position; the average amount of time devoted to the
organization’s affairs per week, month, etc.; and the amount of annual
compensation. The following example shows the format and amount of detail
required:

<table>
<thead>
<tr>
<th>Name</th>
<th>Position</th>
<th>Time devoted</th>
<th>Annual salary</th>
</tr>
</thead>
</table>

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Philip Poe  President and general manager  16 hrs, per wk.  $7,500

Line 18. - Enter the total of employees’ salaries not reported on line 17.

Line 19. - Enter the total interest expense for the year, excluding mortgage interest treated as occupancy expense on line 20.

Line 20. - Enter the amount paid for the use of office space or other facilities, heat, light, power, and other utilities, outside janitorial services, mortgage interest, real estate taxes, and similar expenses.

Line 21. - If your organization records depreciation, depletion, and similar expenses, enter the total.

Line 22. - Attach a schedule listing the type and amount of each significant expense for which a separate line is not provided. Report other miscellaneous expenses as a single total if not substantial in amount.

B. Balance Sheet

Line 1. - Enter the total cash in checking and savings accounts, temporary cash investments (money market funds, CDs, treasury bills, or other obligations that mature in less than 1 year), change funds, and petty cash funds.

Line 2. - Enter the total accounts receivable that arose from the sale of goods and/or performance of services, less any reserve for bad debt.

Line 3. - Enter the amount of materials, goods, and supplies purchased or manufactured by the organization and held to be sold or used in some future period.

Line 4. - Attach a schedule that shows the name of the borrower, a brief description of the obligation, the rate of return on the principal indebtedness, the due date, and the amount due. The following example shows the format and amount of detail required:

<table>
<thead>
<tr>
<th>Name of borrower</th>
<th>Description of obligation</th>
<th>Rate of return</th>
<th>Due date</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hope Soap Corp.</td>
<td>Debenture bond (no senior issue outstanding)</td>
<td>10%</td>
<td>Jan. 1999</td>
<td>$ 7,500</td>
</tr>
<tr>
<td>Big Spool Co.</td>
<td>Collateral note secured by company’s fleet of 20 delivery trucks</td>
<td>12%</td>
<td>Jan. 1998</td>
<td>62,000</td>
</tr>
</tbody>
</table>

Line 5. - Attach a schedule listing the organization’s corporate stock holdings. For stock of closely held corporations, the statement should show the name of the corporation, a brief summary of the corporation’s capital structure, and the number of shares held and their value as carried on the organization’s books. If such valuation does not reflect current fair market value, also include fair market value. For stock traded on an organized exchange or in substantial quantities over the counter, the statement should show the name of the corporation, a description of the stock and the principal exchange on which it is traded, the number of shares held, and their value as carried on the organization’s books. The following example shows the format...
and the amount of detail required:

<table>
<thead>
<tr>
<th>Name of corporation</th>
<th>Capital structure (or exchange on which traded)</th>
<th>Shares</th>
<th>Book amount</th>
<th>Fair market value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Little Spool Corporation</td>
<td>100 shares nonvoting preferred issued and outstanding, no par value; 50 shares common issued and outstanding, no par value.</td>
<td>Preferred shares: 50 20,000 $24,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Common shares: 10 25,000 30,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Flintlock Corporation</td>
<td>Class A common</td>
<td>20 3,000 3,500</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Line 6. - Report each loan separately, even if more than one loan was made to the same person. Attach a schedule that shows the borrower’s name, purpose of loan, repayment terms, interest rate, and original amount of loan.

Line 7. - Enter the book value of government securities held (U.S., state, or municipal). Also enter the book value of buildings and equipment held for investment purposes. Attach a schedule identifying and reporting the book value of each.

Line 8. - Enter the book value of buildings and equipment not held for investment. This includes plant and equipment used by the organization in conducting its exempt activities. Attach a schedule listing these assets held at the end of the current tax year/period and the cost or other basis.

Line 9. - Enter the book value of land not held for investment.

Line 10. - Enter the book value of each category of assets not reported on lines 1 through 9. Attach a schedule listing each.

Line 12. - Enter the total of accounts payable to suppliers and others, such as salaries payable, accrued payroll taxes, and interest payable.

Line 13. - Enter the unpaid portion of grants and contributions that the organization has made a commitment to pay other organizations or individuals.

Line 14. - Enter the total of mortgages and other notes payable outstanding at the end of the current tax year/period. Attach a schedule that shows each item separately and the lender’s name, purpose of loan, repayment terms, interest rate, and original amount.

Line 15. - Enter the amount of each liability not reported on lines 12 through 14. Attach a separate schedule.

Line 17. - Under fund accounting, an organization segregates its assets, liabilities, and net assets into separate funds according to restrictions on the use of certain assets. Each fund is like a separate entity in that it has a self-balancing set of accounts showing assets, liabilities, equity (fund...
balance), income, and expenses. If the organization does not use fund accounting, report only the ‘net assets’ account balances, such as: capital stock, paid-in capital, and retained earnings or accumulated income.

Page 6

Procedural Checklist

Make sure the application is complete.

If you do not complete all applicable parts or do not provide all required attachments, we may return the incomplete application to your organization for resubmission with the missing information or attachments. This will delay the processing of the application and may delay the effective date of your organization’s exempt status. The organization may also incur additional user fees.

Have you...

Attached Form 8718 (User Fee for Exempt Organization Determination Letter Request) along with the appropriate fee?

Located the correct key district office for the mailing of the application? (See Where To File on page 1.) Do not file the application with your local Internal Revenue Service Center.

Completed Parts I through IV and any other schedules that apply to the organization?

Shown the organization’s employer identification number?

a. If your organization has one, write it in the space provided.

b. If this is a newly formed organization and does not have an employer identification number, obtain an EIN by telephone. (See Part I, Line 2 instructions.)

Described your organization’s specific activities as directed in Part II, line 1 of the application?

Included a conformed copy of the complete organizing instrument? (See Part I, line 11 instructions.)

Had the application signed by one of the following:

a. An officer or trustee who is authorized to sign (e.g., president, treasurer); or

b. A person authorized by a power of attorney (submit Form 2848, 8821, or other power of attorney)?

Enclosed financial statements (Part IV)?

a. Current year (must include period up to within 60 days of the date the application is filed) and 3 preceding years.

b. Detailed breakdown of revenue and expenses (no lump sums).
c. If the organization has been in existence less than 1 year, you must also submit proposed budgets for 2 years showing the amounts and types of receipts and expenditures anticipated.

Note: During the technical review of a completed application by the Employee Plans/Exempt Organizations Division in the key district or by Exempt Organizations Technical Division in the National Office, it may be necessary to contact the organization for more specific or additional information.

Do not send this checklist with the application.

Instructions

A 'school' is an organization that has the primary function of presenting formal instruction, normally maintains a regular faculty and curriculum, normally has a regularly enrolled student body, and has a place where its educational activities are carried on. The term generally corresponds to the definition of an 'educational organization' in section 170(b)(1)(A)(ii). Thus, the term includes primary, secondary, preparatory and high schools, and colleges and universities. The term does not include organizations engaged in both educational and noneducational activities unless the latter are merely incidental to the educational activities. A school for handicapped children is included within the term, but an organization merely providing handicapped children with custodial care is not.

For purposes of this schedule, 'Sunday schools' that are conducted by a church are not included in the term 'schools,' but separately organized schools (such as parochial schools, universities, and similar institutions) are included in the term.

A private school that otherwise meets the requirements of section 501(c)(3) as an educational institution will not qualify for exemption under section 501(a) unless it has a racially nondiscriminatory policy as to students. This policy means that the school admits students of any race to all the rights, privileges, programs, and activities generally accorded or made available to students at that school, and that the school does not discriminate on the basis of race in the administration of its educational policies, admissions policies, scholarship and loan programs, and athletic or other school-administered programs. The IRS considers discrimination on the basis of race to include discrimination on the basis of color and national or ethnic origin. A policy of a school that favors racial minority groups in admissions, facilities, programs, and financial assistance will not constitute discrimination on the basis of race when the purpose and effect is to promote the establishment and maintenance of that school's racially nondiscriminatory policy as to students. See Rev. Proc. 75-50, 1975-2 C.B. 587, for guidelines and recordkeeping requirements for determining whether private schools that are applying for recognition of exemption have racially nondiscriminatory policies as to students.

Line 2

An instrumentality of a state or political subdivision of a state may qualify under section 501(c)(3) if it is organized as a separate entity from the governmental unit that created it and if it otherwise meets the organizational and operational tests of section 501(c)(3). (See Rev. Rul. 60-384, 1960-2 C.B. 172.) Any such organization that is a school is not a private school and,
therefore, is not subject to the provisions of Rev. Proc. 75-50.

Schools that incorrectly answer 'Yes' to line 2 will be contacted to furnish the information called for by lines 3 through 10 in order to establish that they meet the requirements for exemption. To prevent delay in the processing of your application, be sure to answer line 2 correctly and complete lines 3 through 10, if applicable.

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Additional Information

Hospitals

To entitled to status as a 'hospital,' an organization must have, as its be principal purpose or function, the providing of medical or hospital care or medical education or research. 'Medical care' includes the treatment of any physical or mental disability or condition, the cost of which may be taken as a deduction under section 213, whether the treatment is performed on an inpatient or outpatient basis. Thus, a rehabilitation institution, outpatient clinic, or community mental health or drug treatment center may be a hospital if its principal function is providing the above-described services.

On the other hand, a convalescent home or a home for children or the aged is not a hospital. Similarly, an institution whose principal purpose or function is to train handicapped individuals to pursue some vocation is not a hospital. Moreover, a medical education or medical research institution is not a hospital, unless it is also actively engaged in providing medical or hospital care to patients on its premises or in its facilities on an inpatient or outpatient basis.

Cooperative Hospital Service Organizations

Cooperative hospital service organizations (section 501(e)) should not complete Schedule C.

Medical Research Organizations

To qualify as a medical research organization, the principal function of the organization must be the direct, continuous, and active conduct of medical research in conjunction with a hospital that is described in section 501(c)(3), a Federal hospital, or an instrumentality of a governmental unit referred to in section 170(c)(1). For purposes of section 170(b)(1)(A)(iii) only, the organization must be set up to use the funds it receives in the active conduct of medical research by January 1 of the fifth calendar year after receipt. The arrangement it has with donors to assure use of the funds within the 5-year period must be legally enforceable. As used here, 'medical research' means investigations, experiments, and studies to discover, develop, or verify knowledge relating to the causes, diagnosis, treatment, prevention, or control of human physical or mental diseases and impairments. For further information, see Regulations section 1.170A-9(c)(2).

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Instructions

If the organization claims to be an operating foundation described in section 4942(j)(3) and -

Page 20
a. Bases its claim to private operating foundation status on normal and regular operations over a period of years; or

b. Is newly created, set up as a private operating foundation, and has at least 1 year's experience;

provide the information under the income test and under one of the three supplemental tests (assets, endowment, or support). If the organization does not have at least 1 year's experience, provide the information called for on line 21. If the organization's private operating foundation status depends on its normal and regular operations as described in a above, attach a schedule similar to Schedule E showing the data in tabular form for the 3 years preceding the most recent tax year. (See Regulations section 53.4942(b)-1 for additional information before completing the 'Income Test' section of this schedule.) Organizations claiming section 4942(i)(5) status must satisfy the income test and the endowment test.

A 'private operating foundation' described in section 4942(j)(3) is a private foundation that spends substantially all of its adjusted net income (as defined below) or its minimum investment return directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated. The foundation must satisfy the income test under section 4942(j)(3)(A), as modified by Regulations section 53.4942(b)-1, and one of the following three supplemental tests: (1) the assets test under section 4942(j)(3)(B)(i); (2) the endowment test under section 4942(j)(3)(B)(ii); or (3) the support test under section 4942(j)(3)(B)(iii).

Certain long-term care facilities described in section 4942(j)(5) are treated as private operating foundations for purposes of section 4942 only.

'Adjusted net income' is the excess of gross income for the tax year over the sum of deductions determined with the modifications described below. Items of gross income from any unrelated trade or business and the deductions directly connected with the unrelated trade or business are taken into account in computing the organization's adjusted net income.

Income Modifications

The following are income modifications (adjustments to gross income):

1. Section 103 (relating to interest on certain governmental obligations) does not apply. Thus, interest that otherwise would have been excluded should be included in gross income.

2. Except as provided in 3 below, capital gains and losses are taken into account only to the extent of the net short-term gain. Long-term gains and losses are disregarded.

3. The gross amount received from the sale or disposition of certain property should be included in gross income to the extent that the acquisition of the property constituted a qualifying distribution under section 4942(g)(1)(B).

4. Repayments of prior qualifying distributions (as defined in section 4942(g)(1)(A)) constitute items of gross income.

5. Any amount set aside under section 4942(g)(2) that is 'not necessary for
the purposes for which it was set aside' constitutes an item of gross income.

Deduction Modifications

The following are deduction modifications (adjustments to deductions):

1. Expenses for the general operation of the organization according to its charitable purposes (as contrasted with expenses for the production or collection of income and management, conservation, or maintenance of income-producing property) should not be taken as deductions. If only a portion of the property is used for production of income subject to section 4942 and the remainder is used for general charitable purposes, the expenses connected with that property should be divided according to those purposes. Only expenses related to the income-producing portion should be taken as deductions.

2. Charitable contributions, deductible under section 170 or 642(c), should not be taken into account as deductions for adjusted net income.

3. The net operating loss deduction prescribed under section 172 should not be taken into account as a deduction for adjusted net income.

4. The special deductions for corporations (such as the dividends-received deduction) allowed under sections 241 through 249 should not be taken into account as deductions for adjusted net income.

5. Depreciation and depletion should be determined in the same manner as under section 4940(c)(3)(B).

Section 265 (relating to the expenses and interest connected with tax-exempt income) should not be taken into account.

You may find it easier to figure adjusted net income by completing Column (c), Part 1, Form 990-PF, according to the instructions for that form.

An organization that has been held to be a private operating foundation will continue to be such an organization only if it meets the income test and either the assets, endowment, or support test in later years. See Regulations section 53.4942(b) for additional information. No additional request for ruling will be necessary or appropriate for an organization to maintain its status as a private operating foundation. However, data related to the above tests must be submitted with the organization’s annual information return, Form 990-PF.

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Instructions

Line 1

Provide the criteria for admission to the home and submit brochures, pamphlets, or other printed material used to inform the public about the home’s admissions policy.

Line 2

Indicate whether the fee charged is an entrance fee or a monthly charge, etc. Also, if the fee is an entrance fee, is it payable in a lump sum or on an
installment basis? If there is no fee, indicate 'N/A.'

Line 4
Indicate the organization's policy regarding residents who are unable to pay. Also, indicate whether the organization is subsidized for all or part of the cost of maintaining those residents who are unable to pay.

Line 5
Indicate whether the organization provides health care to the residents, either directly or indirectly, through some continuing arrangement with other organizations, facilities, or health personnel. If no health care is provided, indicate 'N/A.'

Page 24
Additional Information

Private foundations that make grants to individuals for travel, study, or other similar purposes are required to obtain advance approval of their grant procedures from the IRS. Such grants that are awarded under selection procedures that have not been approved by the IRS are subject to a 10% excise tax under section 4945. (See Regulations sections 53.4945-4(c) and (d).)

If you are requesting advance approval of the organization's grant procedures, the following sections apply to line 1c:

4945(g)(1) - The grant constitutes a scholarship or fellowship grant that meets the provisions of section 117(a) prior to its amendment by the Tax Reform Act of 1986 and is to be used for study at an educational organization (school) described in section 170(b)(1)(A)(ii).

4945(g)(2) - The grant constitutes a prize or award that is subject to the provisions of section 74(b), if the recipient of such a prize or award is selected from the general public.

4945(g)(3) - The purpose of the grant is to achieve a specific objective, produce a report or other similar product, or improve or enhance a literary, artistic, musical, scientific, teaching, or other similar capacity, skill, or talent of the grantee.

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Activity Code Numbers of Exempt Organizations (select up to three codes that best describe or most accurately identify your organization's purposes, activities, operations or type of organization and enter in block 6, page 1, of the application. Enter first the code that most accurately identifies the organization.)

Code

Religious Activities

001 Church, synagogue, etc.
002 Association or convention of churches
003 Religious order
004 Church auxiliary
005 Mission
006 Missionary activities
007 Evangelism
008 Religious publishing activities
  --- Bookstore (use 918)
  --- Genealogical activities (use 094)
029 Other religious activities

Schools, Colleges, and Related Activities

030 School, college, trade school, etc.
031 Special school for the blind, handicapped, etc.
032 Nursery school
  --- Day care center (use 574)
033 Faculty group
034 Alumni association or group
035 Parent or parent-teachers association
036 Fraternity or sorority
  --- Key club (use 323)
037 Other student society or group
038 School or college athletic association
039 Scholarships for children of employees
040 Scholarships (other)
041 Student loans
042 Student housing activities
043 Other student aid
044 Student exchange with foreign country
045 Student operated business
  --- Financial support of schools, colleges, etc. (use 602)
  --- Achievement prizes or awards (use 914)
  --- Student bookstore (use 918)
  --- Student travel (use 299)
  --- Scientific research (see Scientific Research Activities)
046 Private school
059 Other school related activities

Cultural, Historical or Other Educational Activities

060 Museum, zoo, planetarium, etc.
061 Library
062 Historical site, records, or reenactment
063 Monument
064 Commemorative event (centennial, festival, pageant, etc.)
065 Fair
068 Community theatrical group
069 Singing society or group
090 Cultural performances
091 Art exhibit
092 Literary activities
093 Cultural exchanges with foreign country
094 Genealogical activities
  --- Achievement prizes or awards (use 914)
  --- Gifts or grants to individuals (use 561)
  --- Financial support of cultural organizations (use 602)
119 Other cultural or historical activities

Other Instruction and Training Activities
Publishing Activities
121 Radio or television broadcasting
122 Producing films
123 Discussion groups, forums, panels, lectures, etc.
124 Study and research (nonscientific)
125 Giving information or opinion (see also Advocacy)
126 Apprentice training
--- Travel tours (use 299)
149 Other Instruction and training

Health Services and Related Activities
150 Hospital
151 Hospital auxiliary
152 Nursing or convalescent home
153 Care and housing for the aged (see also 382)
154 Health clinic
155 Rural medical facility
156 Blood bank
157 Cooperative hospital service organization
158 Rescue and emergency service
159 Nurses register or bureau
160 Aid to the handicapped (see also 031)
161 Scientific research (diseases)
162 Other medical research
163 Health insurance (medical, dental, optical, etc.)
164 Prepared group health plan
165 Community health planning
166 Mental health care
167 Group medical practice association
168 In-faculty group practice association
169 Hospital pharmacy, barking facility food services, etc.
179 Other health services

Scientific Research Activities
180 Contract or sponsored scientific research for industry
181 Scientific research for government
--- Scientific research (diseases) (use 161)
199 Other scientific research activities

Business and Professional Organizations
200 Business promotion (chamber of commerce, business league, etc.)
201 Real estate association
202 Board of trade
203 Regulating business
204 Promotion of fair business practices
205 Professional association
206 Professional association auxiliary
207 Industry trade shows
208 Convention displays
--- Testing products for public safety (use 905)
209 Research, development, and testing
210 Professional athletic league
--- Attracting new industry (use 403)
--- Publishing activities (use 120)
--- Insurance or other benefits for members (see Employee or Membership
Benefit Organizations)
211 Underwriting municipal insurance
212 Assigned risk insurance activities
213 Tourist bureau
229 Other business or professional group

Farming and Related Activities
230 Farming
231 Farm bureau
232 Agricultural group
233 Horticultural group
234 Farmers cooperative marketing or purchasing
235 Financing crop operations
--- FFA, FHA, 4-H club, etc. (use 322)
--- Fair (use 085)
236 Dairy herd improvement association
237 Breeders association
249 Other farming and related activities

Mutual Organizations
250 Mutual ditch, irrigation, telephone, electric company, or like organization
251 Credit union
252 Reserve funds or insurance for domestic building and loan association, cooperative bank, or mutual savings bank
253 Mutual insurance company
254 Corporation organized under an Act of Congress (see also 904)
--- Farmers cooperative marketing or purchasing (use 234)
--- Cooperative hospital service organization (use 157)
259 Other mutual organization

Employee or Membership Benefit Organizations
260 Fraternal beneficiary society order or association
261 Improvement of conditions of workers
262 Association of municipal employees
263 Association of employees
264 Employee or member welfare association
265 Sick, accident, death, or similar benefits
266 Strike benefits
267 Unemployment benefits
268 Pension or retirement benefits
269 Vacation benefits
279 Other services or benefits to members or employees

Sports, Athletic, Recreational, and Social Activities
280 Country club
281 Hobby club
282 Dinner club
283 Variety club
284 Dog club
285 Women’s club
--- Garden club (use 356)
286 Hunting or fishing club
287 Swimming or tennis club
Other sports club
--- Boys Club, Little League, etc. (use 321)
296 Community center
297 Community recreational facilities (park, playground, etc.)
298 Training in sports
299 Travel tours
300 Amateur athletic association
--- School or college athletic association (use 038)
301 Fundraising athletic or sports event
317 Other sports or athletic activities
318 Other recreational activities
319 Other social activities

Youth Activities
320 Boy Scouts, Girl Scouts, etc.
321 Boys Club, Little League, etc.
322 FFA, FHA, 4-H club, etc.
323 Key club
324 YMCA, YWCA, YMHA, etc.
325 Camp
326 Care and housing of children (orphanage, etc.)
327 Prevention of cruelty to children
328 Combat juvenile delinquency
349 Other youth organization or activities

Conservation, Environmental, and Beautification Activities
350 Preservation of natural resources (conservation)
351 Combating or preventing pollution (air, water, etc.)
352 Land acquisition for preservation
353 Soil or water conservation
354 Preservation of scenic beauty
--- Litigation (see Litigation and Legal Aid Activities)
--- Combat community deterioration (use 402)
355 Wildlife sanctuary or refuge
356 Garden club
379 Other conservation, environmental, or beautification activities

Housing Activities
380 Low-income housing
381 Low and moderate income housing
382 Housing for the aged (see also 168)
--- Nursing or convalescent home (use 152)
--- Student housing (use 042)
--- Orphanage (use 326)
398 Instruction and guidance on housing
399 Other housing activities

Inner City or Community Activities
400 Area development, redevelopment, or renewal
--- Housing (see Housing Activities)
401 Homeowners association
402 Other activity aimed at combating community deterioration
403 Attracting new industry or retaining industry in an area
404 Community promotion
--- Community recreational facility (use 297)
--- Community center (use 296)
405 Loans or grants for minority businesses
--- Job training, counseling, or assistance (use 566)
--- Day care center (use 574)
--- Referral service (social agencies) (use 569)
--- Legal aid to indigents (use 462)
406 Crime prevention
407 Voluntary firemen's organization or auxiliary
--- Rescue squad (use 158)
408 Community service organization
429 Other inner city or community benefit activities

Civil Rights Activities

430 Defense of human and civil rights
431 Elimination of prejudice and discrimination (race, religion, sex, national origin, etc.)
432 Lessen neighborhood tensions
449 Other civil rights activities

Litigation and Legal Aid Activities

460 Public interest litigation activities
461 Other litigation or support of litigation
462 Legal aid to indigents
463 Providing bail
465 Plan under IRC section 120

Legislative and Political Activities

480 Propose, support, or oppose legislation
481 Voter information on issues or candidates
482 Voter education (mechanics of registering, voting, etc.)
483 Support, oppose, or rate political candidates
484 Provide facilities or services for political campaign activities
509 Other legislative and political activities

Advocacy

Attempt to influence public opinion concerning:

510 Firearms control
511 Selective Service System
512 National defense policy
513 Weapons systems
514 Government spending
515 Taxes or tax exemption
516 Separation of church and state
517 Government aid to parochial schools
518 U.S. foreign policy
519 U.S. military government
520 Pacifism and peace
521 Economic-political system of U.S.
522 Anti-communism
523 Right to work
524 Zoning or rezoning
525 Location of highway or transportation system
Rights of criminal defendants  
Capital punishment  
Stricter law enforcement  
Ecology or conservation  
Protection of consumer interests  
Medical care service  
Welfare system  
Urban renewal  
Busing students to achieve racial balance  
Racial integration  
Use of intoxicating beverages  
Use of drugs or narcotics  
Use of tobacco  
Prohibition of erotica  
Sex education in public schools  
Population control  
Birth control methods  
Legalized abortion  
Other matters  

Other Activities Directed to Individuals  
Supplying money, goods, or services to the poor  
Gifts or grants to individuals (other than scholarships)  
Scholarships for children of employees (use 039)  
Scholarships (other) (use 040)  
Student loans (use 041)  
Other loans to individuals  
Marriage counseling  
Family planning  
Credit counseling and assistance  
Job training, counseling, or assistance  
Draft counseling  
Vocational counseling  
Referral service (social agencies)  
Rehabilitating convicts or ex-convicts  
Rehabilitating alcoholics, drug abusers, compulsive gamblers, etc.  
Day care center  
Services for the aged (see also 153 and 382)  
Training of or aid to the handicapped (see 031 and 150)  

Activities Directed to Other Organizations  
Community Chest, United Way, etc.  
Booster club  
Gifts, grants, or loans to other organizations  
Nonfinancial services or facilities to other organizations  

Other Purposes and Activities  
Cemetery or burial activities  
Perpetual care fund (cemetery, columbarium, etc.)  
Emergency or disaster aid fund  
Community trust or component  
Government instrumentality or agency (see also 254)  
Testing products for public safety  
Veterans activities
Patriotic activities
4947(a)(1) trust
Domestic organization with activities outside U.S.
Foreign organization
Title holding corporation
Prevention of cruelty to animals
Achievement prizes or awards
Erection or maintenance of public building or works
Cafeteria, restaurant, snack bar, food services, etc.
Thrift shop, retail outlet, etc.
Book, gift, or supply store
Advertising
Association of employees
Loans or credit reporting
Endowment fund or financial services
Indians (tribes, cultures, etc.)
Traffic or tariff bureau
Section 501(c)(1) with 50% deductibility
Government instrumentality other than section 501(c)
Fundraising
4947(a)(2) trust
Prepaid legal services plan exempt under IRC section 501(c)(20)
Withdrawal liability payment fund
Section 501(k) child care organization
APPENDIX D

I.R.S. Form 1024, Application for Recognition of Exemption Under Section 501(a) or for Determination Under Section 120
Form 1024
Application for Recognition of Exemption
Under Section 501(a)
or for Determination Under Section 120

Department of the Treasury
Internal Revenue Service

Read the instructions for each Part carefully.
A User Fee must be attached to this application.
If the required information and appropriate documents are not submitted along with Form 8718 (with payment of the appropriate user fee), the application may be returned to the organization.
Complete the Procedural Checklist in the instructions.

Part I. - Identification of Applicant (Must be completed by all applicants; also complete appropriate schedule.)
Submit only the schedule that applies to your organization. Do not submit blank schedules.

Check the appropriate box below to indicate the section under which the organization is applying:

- Section 501(c)(2) - Title holding corporations (Schedule A, page 7)
- Section 501(c)(7) - Social clubs (Schedule D, page 11)
- Section 501(c)(8) - Fraternal beneficiary associations (Schedule E, page 13)
- Section 501(c)(9) - Voluntary employees' beneficiary associations (Parts I through IV and Schedule F, page 14)
- Section 501(c)(10) - Domestic fraternal societies, orders, etc. (Schedule E, page 13)
- Section 501(c)(11) - Benevolent life insurance associations, mutual life or insurance companies, mutual or cooperative telephone companies, or like organizations (Schedule G, page 15)
- Section 501(c)(12) - Cemeteries, crematoria, and like corporations (Schedule H, page 16)
- Section 501(c)(15) - Mutual insurance companies or associations, other than life or marine (Schedule I, page 17)
- Section 501(c)(17) - Trusts providing for the payment of supplemental unemployment compensation benefits (Parts I through IV and Schedule J, page 18)
- Section 501(c)(19) - A past, present, auxiliary unit, etc., of past or present members of the Armed Forces of the United States (Schedule K, page 19)
- Section 501(c)(20) - Trust or organization for prepaid group legal services (Parts I, II, and Schedule M, page 23) See Change To Note in instructions.
- Section 501(c)(25) - Title holding corporations or trusts (Schedule A, page 7)
- Section 120 - Qualified group legal services plans (Part I and Schedule L, page 21) See Change To Note in instructions.

1a Full name of organization (as shown in organizing document)
2 Employer identification number (if none, see Specific Instructions)

1b c/o Name (if applicable)
1c Address (number and street)
1d City or town, county, state, and ZIP code
3 Name and telephone number (including area code) of person to be contacted during business hours if more information is needed
4 Month the annual accounting period ends
5 Date incorporated or formed
6 Activity codes (see instructions)

7 Did the organization previously apply for recognition of exemption under this Code section or any other section of the Code? 
   "Yes" attach an explanation.
   "No"

8 Has the organization filed Federal income tax returns or exempt organization information returns? 
   "Yes" state the form numbers, years filed, and Internal Revenue office where filed.
   "No"

9 Check the box for your type of organization. BE SURE TO ATTACH A CONFORMED COPY OF THE CORRESPONDING DOCUMENTS TO
   THE APPLICATION BEFORE MAILING.
   - Corporation - Attach a copy of the Articles of Incorporation, (including amendments and restatements) showing approval by
     the appropriate state official; also attach a copy of the bylaws.
   - Trust - Attach a copy of the Trust Indenture or Agreement, including all appropriate signatures and dates.
   - Association - Attach a copy of the Articles of Association, Constitution, or other creating document, with a declaration (see instructions) or
     other evidence that the organization was formed by adoption of the document by more than one person; also include a copy of the bylaws.

   If this is a corporation or an unincorporated association that has not yet adopted bylaws, check here: 

   PLEASE SIGN HERE

   (Signature) (Title or authority of agent) (Date)

Form 1024 (Rev. 8-93)
Part II. Activities and Operational Information (Must be completed by all applicants other than those applying under section 120.)

1. Provide a detailed narrative description of all the activities of the organization — past, present, and planned. Do not merely refer to or repeat the language in the organizational document. Describe each activity separately in the order of importance. Each description should include, as a minimum, the following: (a) a detailed description of the activity including its purpose; (b) when the activity was or will be initiated; and (c) where and by whom the activity will be conducted.

2. List the organization’s present and future sources of financial support, beginning with the largest source first.
**Part II. Activities and Operational Information (continued)**

3. Give the following information about the organization's governing body:

<table>
<thead>
<tr>
<th>a Names, addresses, and titles of officers, directors, trustees, etc.</th>
<th>b Annual compensation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

4. If the organization is the outgrowth or continuation of any form of predecessor, state the name of each predecessor, the period during which it was in existence, and the reasons for its termination. Submit copies of all papers by which any transfer of assets was effected.

5. If the applicant organization is now, or plans to be connected in any way with any other organization, describe the organization and explain the relationship (e.g., financial support on a continuing basis; shared facilities or employees; same officers, directors, or trustees).

6. If the organization has capital stock issued and outstanding, state: (1) class or classes of the stock; (2) number and par value of the shares; (3) consideration for which they were issued; and (4) whether any dividends have been paid or whether your creating instrument authorizes dividend payments on any class of capital stock.

7. State the qualifications necessary for membership in the organization; the classes of membership (with the number of members in each class); and the voting rights and privileges received. If any group or class of persons is required to join, describe the requirement and explain the relationship between those members and members who join voluntarily. Submit copies of any membership solicitation material. Attach sample copies of all types of membership certificates issued.

8. Explain how your organization's assets will be distributed on dissolution.
Part II. Activities and Operational Information (continued)

9 Has the organization made or does it plan to make any distribution of its property or surplus funds to shareholders or members? 

   Yes □ No □

If "Yes," state the full details, including: (1) amounts or value; (2) source of funds or property distributed or to be distributed; and (3) basis of, and authority for, distribution or planned distribution.

10 Does, or will, any part of your organization's receipts represent payments for services performed or to be performed? 

   Yes □ No □

If "Yes," state in detail the amount received and the character of the services performed or to be performed.

11 Has the organization made, or does it plan to make, any payments to members or shareholders for services performed or to be performed? 

   Yes □ No □

If "Yes," state in detail the amount paid, the character of the services, and to whom the payments have been, or will be, made.

12 Does the organization have any arrangement to provide insurance for members, their dependents, or others (including provisions for the payment of sick or death benefits, pensions or annuities)? 

   Yes □ No □

If "Yes," describe and explain the arrangement's eligibility rules and attach a sample copy of each plan document and each type of policy issued.

13 Is the organization under the supervisory jurisdiction of any public regulatory body, such as a social welfare agency, etc.? 

   Yes □ No □

If "Yes," submit copies of all administrative opinions or court decisions regarding this supervision, as well as copies of applications or requests for the opinions or decisions.

14 Does the organization now lease or does it plan to lease any property? 

   Yes □ No □

If "Yes," explain in detail, include the amount of rent, a description of the property, and any relationship between the applicant organization and the other party. Also, attach a copy of any rental or lease agreement.

15 Has the organization spent or does it plan to spend any money attempting to influence the selection, nomination, election or appointment of any person to any Federal, state, or local public office or to an office in a political organization? 

   Yes □ No □

If "Yes," explain in detail and list the amounts spent or to be spent in each case.

16 Does the organization publish pamphlets, brochures, newsletters, journals, or similar printed material? 

   Yes □ No □

If "Yes," attach a recent copy of each.
Form 1024 (Rev. 8-93)  Page 6

Part III. Financial Data (Must be completed by all applicants other than those applying under section 501(c)(20) or 120.)

Complete the financial statements for the current year and for each of the 3 years immediately before it. If in existence less than 4 years, complete the statements for each year in existence. If in existence less than 1 year, also provide proposed budgets for the 2 years following the current year.

A. Statement of Revenue and Expenses

<table>
<thead>
<tr>
<th>Revenue</th>
<th>(a) Current Tax Year</th>
<th>(b) 19</th>
<th>(c) 19</th>
<th>(d) 19</th>
<th>(e) Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Gross dues and assessments of members</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Gross contributions, gifts, etc.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Gross amounts derived from activities related to the organization's exempt purposes (attach schedule)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Gross amounts from unrelated business activities (attach schedule)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Gain from sale of assets, excluding inventory items (attach schedule)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Investment income (see instructions)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Other revenue (attach schedule)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. Total revenue (add lines 1 through 7)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Expenses

<table>
<thead>
<tr>
<th>Expenses</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>9. Expenses attributable to activities related to the organization's exempt purposes</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10. Expenses attributable to unrelated business activities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11. Contributions, gifts, grants, and similar amounts paid (attach schedule)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12. Disbursements to or for the benefit of members (attach schedule)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13. Compensation of officers, directors, and trustees (attach schedule)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>14. Other salaries and wages</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15. Interest</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>16. Occupancy</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>17. Depreciation and depletion</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>18. Other expenses (attach schedule)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>19. Total expenses (add line 18)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>20. Excess of revenue over expenses (line 8 minus line 19)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

B. Balance Sheet (at the end of the period shown)

<table>
<thead>
<tr>
<th>Assets</th>
<th>Current Tax Year as of</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Cash</td>
<td></td>
</tr>
<tr>
<td>2. Accounts receivable, net</td>
<td></td>
</tr>
<tr>
<td>3. Inventories</td>
<td></td>
</tr>
<tr>
<td>4. Bonds and notes receivable (attach schedule)</td>
<td></td>
</tr>
<tr>
<td>5. Corporate stocks</td>
<td></td>
</tr>
<tr>
<td>6. Mortgage loans (attach schedule)</td>
<td></td>
</tr>
<tr>
<td>7. Other investments (attach schedule)</td>
<td></td>
</tr>
<tr>
<td>8. Depreciable and depletable assets (attach schedule)</td>
<td></td>
</tr>
<tr>
<td>9. Land</td>
<td></td>
</tr>
<tr>
<td>10. Other assets (attach schedule)</td>
<td></td>
</tr>
<tr>
<td>11. Total assets</td>
<td></td>
</tr>
<tr>
<td>12. Accounts payable</td>
<td></td>
</tr>
<tr>
<td>13. Contributions, gifts, grants, etc., payable</td>
<td></td>
</tr>
<tr>
<td>14. Mortgages and notes payable (attach schedule)</td>
<td></td>
</tr>
<tr>
<td>15. Other liabilities (attach schedule)</td>
<td></td>
</tr>
<tr>
<td>16. Total liabilities</td>
<td></td>
</tr>
<tr>
<td>Fund Balances or Net Assets</td>
<td></td>
</tr>
<tr>
<td>17. Total fund balances or net assets (add line 16 and line 17)</td>
<td></td>
</tr>
<tr>
<td>18. Total liabilities and fund balances or net assets (add line 16 and line 17)</td>
<td></td>
</tr>
</tbody>
</table>

If there has been any substantial change in any aspect of the organization's financial activities since the end of the period shown above, check the box and attach a detailed explanation.

For Paperwork Reduction Act Notice, see IRS Form 1024. CS1 Form 1024 (Rev. 8-93)
Part IV. Notice Requirements (Sections 501(c)(9) and 501(c)(17) Organizations Only)

See Change To Note in the instructions

<table>
<thead>
<tr>
<th>Section 501(c)(9) and 501(c)(17) organizations:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Are you filing Form 1024 within 15 months from the end of the month in which the organization was created or formed as required by section 501(c)?</td>
</tr>
<tr>
<td>Yes</td>
</tr>
</tbody>
</table>

If "Yes," skip the rest of this Part.

If "No," answer question 2.

<table>
<thead>
<tr>
<th>Question 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>If you answer &quot;No&quot; to question 1, are you filing Form 1024 within 27 months from the end of the month in which the organization was created or formed?</td>
</tr>
<tr>
<td>Yes</td>
</tr>
</tbody>
</table>


If "No," answer question 3.

<table>
<thead>
<tr>
<th>Question 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>If you answer &quot;No,&quot; to question 2, has the organization been contacted by the IRS regarding its failure to file Form 1024 within 27 months from the end of the month in which the organization was created or formed?</td>
</tr>
<tr>
<td>Yes</td>
</tr>
</tbody>
</table>

If "No," your organization qualifies for an extension of time to apply under the "reasonable action and good faith" requirements of section 401 of Rev. Proc. 92-65. Do not answer questions 4 and 5.

If "Yes," answer question 4.

<table>
<thead>
<tr>
<th>Question 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>If you answer &quot;Yes&quot; to question 3, does the organization wish to request relief from the 15-month filing requirement?</td>
</tr>
<tr>
<td>Yes</td>
</tr>
</tbody>
</table>

If "Yes," give the reasons for not filing this application prior to being contacted by the IRS. See Specific Instructions, Part IV, Line 4, before completing this item. Do not answer question 5.

If "No," answer question 5.

<table>
<thead>
<tr>
<th>Question 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>If you answer &quot;No&quot; to question 4, your organization's qualification as a section 501(c)(9) or 501(c)(17) organization can be recognized only from the date this application is filed with the key District Director. Therefore, does the organization want us consider its application as a request for recognition of exemption as a section 501(c)(9) or 501(c)(17) organization from the date application is received and not retroactively to the date the organization was created or formed?</td>
</tr>
<tr>
<td>Yes</td>
</tr>
</tbody>
</table>
1. State the complete name, address and employer identification number of each organization for which title to property is held and the number and classes of shares of the applicant organization's stock held by each organization.

2. State whether the annual excess of revenue over expenses is or will be turned over to the organization for which title to property is held and, if not, the purpose for which the excess (income) is or will be held.

3a. In the case of a corporation described in section 501(c)(2), state the purpose of each organization for which title to property is held (as shown in its governing instrument) and the Code sections under which each is classified as exempt from income tax.

3b. In the case of a corporation or trust described in section 501(c)(25), state the basis whereby each shareholder is described in section 501(c)(25)(C).

Instructions

Line 1. - Provide the requested information on each organization for which the applicant organization holds title to property. Also indicate the number and types of shares of the applicant organization's stock that are held by each.

Line 2. - For purposes of this question, "excess of revenue over expenses" is all of the organization's income for a particular tax year less operating expenses.

Line 3a. - Give the exempt purpose of each organization that is the basis for its exempt status and the Internal Revenue Code section that describes the organization (as shown in its IRS determination letter).

Line 3b. - Indicate if the shareholder is one of the following:

1. A qualified pension, profit-sharing, or stock bonus plan that meets the requirements of the Code;
2. A government plan;
3. An organization described in section 501(c)(3); or
4. An organization described in section 501(c)(25).
<table>
<thead>
<tr>
<th>Schedule B</th>
<th>Organizations described in section 501(c)(4) (Civic leagues, social welfare organizations (including posts, councils, etc., of veterans' organizations not qualifying or applying for exemption under section 501(c)(19)) or local associations of employees.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Has the Internal Revenue Service previously issued a ruling or determination letter recognizing the applicant organization (or any predecessor organization listed in Item 4 of Part II) to be exempt under section 501(c)(3) and later revoked that recognition on the basis that the applicant organization (or its predecessor) was carrying on propaganda or otherwise attempting to influence legislation or on the basis that it engaged in political activity?</td>
</tr>
<tr>
<td></td>
<td>If &quot;Yes,&quot; indicate the earliest tax year for which recognition of exemption under section 501(c)(3) was revoked and the IRS district office that issued the revocation.</td>
</tr>
<tr>
<td>2</td>
<td>Does the organization perform or plan to perform (for members, shareholders, or others) services, such as maintaining the common areas of a condominium; buying food or other items on a cooperative basis; or providing recreational facilities or transportation services, job placement, or other similar undertakings?</td>
</tr>
<tr>
<td></td>
<td>If &quot;Yes,&quot; explain the activities in detail, including income realized and expenses incurred. Also, explain in detail the nature of the benefits to the general public from these activities. (If the answer to this question is explained in Part II (pages 2, 3, and 4), enter the page and item number here.)</td>
</tr>
<tr>
<td>3</td>
<td>If the organization is claiming exemption as a homeowners' association, is access to any property or facilities it owns or maintains restricted in any way?</td>
</tr>
<tr>
<td></td>
<td>If &quot;Yes,&quot; explain.</td>
</tr>
<tr>
<td>4</td>
<td>If the organization is claiming exemption as a local association of employees, state the name and address of each employer whose employees are eligible for membership in the association. If employees of more than one plant or office of the same employer are eligible for membership, give the address of each plant or office.</td>
</tr>
</tbody>
</table>
Organizations described in section 501(c)(5) (Labor, agricultural, including fishermen's organizations, or horticultural organizations) or section 501(c)(6) (business leagues, chambers of commerce, etc.)

1. Describe any services the organization performs for members or others. (If the description of the services is contained in Part II, enter the page and line number here.)

2. Fishermen's organizations only. - What kinds of aquatic resources (not including minerals) are cultivated or harvested by those eligible for membership in your organization?

3. Labor organizations only. - Is the organization organized under the terms of a collective bargaining agreement?  
   ![Yes/No Options]
   If "Yes," attach a copy of the latest agreement.
**Schedule D**

**Organizations described in section 501(c)(7) (Social clubs)**

1. Has the organization entered or does it plan to enter into any contract or agreement for the management or operation of its property and/or activities, such as restaurants, pro shops, lodges, etc.?  
   - Yes [ ]  
   - No [ ]  
   If "Yes," attach a copy of the contract or agreement. If one has not yet been drawn up, please explain the organization's plans.

2. Does the organization seek or plan to seek public patronage of its facilities or activities by advertisement or otherwise?  
   - Yes [ ]  
   - No [ ]  
   If "Yes," attach sample copies of the advertisements or other requests.  
   If the organization plans to seek public patronage, please explain the plans.

3a. Are nonmembers, other than guests of members, permitted or will they be permitted to use the club facilities or participate in or attend any functions or activities conducted by the organization?  
   - Yes [ ]  
   - No [ ]  
   If "Yes," describe the functions or activities in which there has been or will be nonmember participation or admittance.  
   (Submit a copy of the house rules, if any.)

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No

   - [ ] Yes  
   - [ ] No
Instructions

Line 1.-Answer "Yes," if any of the organization's property or activities will be managed by another organization or company.

Line 3b, c, and d.-Enter the figures for the current year. On an attached schedule, furnish the same information for each of the prior tax years for which you complete Part III of the application.

Line 4e.-If the organization restricts its membership to members of a particular religion, the organization must be:

1. An auxiliary of a fraternal beneficiary society that:

   a. is described in section 501(c)(9) and exempt from tax under section 501(a), and

   b. limits its membership to members of a particular religion;

2. A club that, in good faith, limits its membership to the members of a particular religion in order to further the teachings or principles of that religion and not to exclude individuals of a particular race or color.

If you checked 4e, your explanation must show how the organization meets one of these two requirements.
### Instructions

**Line 1.** - To the extent that they qualify for exemption from Federal income tax, college fraternities and sororities generally qualify as organizations described in section 501(c)(7). Therefore, if the organization is a college fraternity or sorority, refer to the discussion of section 501(c)(7) organizations in Pub. 557. If section 501(c)(7) appears to apply to your organization, complete Schedule D instead of this schedule.

**Line 2.** - Operating under the lodge system means carrying on activities under a form of organization that is comprised of local branches, chartered by a parent organization, largely self-governing, and called lodges, chapters, or the like.
**Schedule F**

Organizations described in section 501(c)(9) (Voluntary employees' beneficiary associations)

1. Describe the benefits available to members. Include copies of any plan documents that describe such benefits and the terms and conditions of eligibility for each benefit.

2. Are any employees or classes of employees entitled to benefits to which other employees or classes of employees are not entitled? [ ] Yes [ ] No

   If "Yes," explain.

3. Give the following information for each plan as of the last day of the most recent plan year and enter that data here.

   If there is more than one plan, attach a separate schedule.

   a. Total number of persons covered by the plan who are highly compensated individuals (See instructions below).
   b. Number of other employees covered by the plan.
   c. Number of employees not covered by the plan.
   d. Total number employed.

4. State the number of persons, if any, other than employees and their dependants (e.g., the proprietor of a business whose employees are members of the association) who are entitled to receive benefits.

---

**Instructions**

Line 3a. The definition of "highly compensated individual" varies depending on the tax year.

For tax years beginning in 1993, "highly compensated individuals" are employees who at any time during the year (or preceding year):

(a) Owned a 5% or larger interest in the employer;
(b) Had compensation from the employer in excess of $36,049.*

(c) Were in the top 20% of employees in compensation and had compensation in excess of $54,245.* or
(d) Were officers of the employer and received compensation in excess of $57,320.50.*

* Under section 414(q), these amounts are adjusted annually based on cost of living increases. The new amounts are announced by the Internal Revenue Service each January.
## Schedule G

Organizations described in section 501(c)(12) (Benevolent life insurance associations, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations)

1. Attach a schedule in columnar form for each tax year for which the organization is claiming exempt status. On each schedule:
   a. Show the total gross income received from members or shareholders.
   b. List by source, the total amounts of gross income received from other sources.

2. If the organization is claiming exemption as a local benevolent insurance association, state:
   a. The counties from which members are accepted or will be accepted.
   b. Whether stipulated premiums are or will be charged in advance, or whether losses are or will be paid solely through assessments.

3. If the organization is claiming exemption as a "like organization," explain how it is similar to a mutual ditch or irrigation company, or a mutual or cooperative telephone company.

4. Are the rights and interests of members in the organization's annual savings determined in proportion to their business with it?  □ Yes □ No
   If "Yes," does the organization keep the records necessary to determine at any time each member's rights and interests in such savings, including assets acquired with the savings?  □ Yes □ No

5. If the organization is a mutual or cooperative telephone company and have contracts with other systems for long-distance telephone services, attach copies of the contracts.

### Instructions

Mutual or cooperative electric or telephone companies should show income received from qualified pole rentals separately. Mutual or cooperative telephone companies should also show separately: the gross amount of income received from nonmember telephone companies for performing services that involve their members and the gross amount of income received from the sale of display advertising in a directory furnished to their members.

Do not net amounts due or paid to other sources, against amounts due or received from, those sources.
Schedule H: Organizations described in section 501(c)(13) (Cemeteries, crematoria, and like corporations)

1. Attach the following documents:
   a. Complete copy of sales contracts or other documents, including any "debt" certificates, involved in acquiring cemetery or crematorium property.
   b. Complete copy of any contract your organization has that designates an agent to sell its cemetery lots.
   c. A copy of the appraisal (obtained from a disinterested and qualified party) of the cemetery property as of the date acquired.

2. Does your organization have, or does it plan to have, a perpetual care fund?  
   If "yes," attach a copy of the fund agreement and explain the nature of the fund (cash, securities, unsold land, etc.)
   
   [ ] Yes  [ ] No

3. If your organization is claiming exemption as a perpetual care fund for an organization described in section 501(c)(13), has the cemetery organization, for which funds are held, established exemption under that section?  
   If "No," explain.
   
   [ ] Yes  [ ] No
Schedule 1  Organizations described in section 501(c)(15) (Small Insurance companies or associations)

1 Is the organization a member of a controlled group of corporations as defined in section 831(b)(2)(B)? (Disregard section 1563(b)(2)(B) in determining whether the organization is a member of a controlled group.) ..........................  □ Yes  □ No

If "Yes," include on lines 2 through 5 the total amount received by the organization and all other members of the controlled group.

If "No," include on lines 2 through 5 only the amounts that relate to the applicant organization.

<table>
<thead>
<tr>
<th>(a) Current Year</th>
<th>3 Prior Tax Years</th>
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<tbody>
<tr>
<td></td>
<td>(b)</td>
</tr>
<tr>
<td>From</td>
<td></td>
</tr>
<tr>
<td>To</td>
<td>19</td>
</tr>
</tbody>
</table>

2 Direct written premiums
3 Reinsurance assumed
4 Reinsurance ceded
5 Net written premiums (line 2; plus line 3; minus line 4)
6 If you entered an amount on line 3 or line 4, attach a copy of the reinsurance agreements the organization has entered into.

Instructions

Line 1. - Answer "Yes," if the organization would be considered a member of a controlled group of corporations if it were not exempt from tax under section 501(a). In applying section 1563(a), use a "more than 50%" stock ownership test to determine whether the applicant or any other corporation is a member of a controlled group.

Line 2. - In addition to other direct written premiums, include on line 2 the full amount of any prepaid or advance premium in the year the prepayment is received. For example, if a $5,000 premium for a 3-year policy was received in the current year, include the full $5,000 amount in the Current Year column.
Organizations described in section 501(c)(17) (Trusts providing for the payment of supplemental unemployment compensation benefits)

If benefits are provided for individual proprietors, partners, or self-employed persons under the plan, explain in detail.

If the plan provides other benefits in addition to the supplemental unemployment compensation benefits, explain in detail and state whether the other benefits are subordinate to the unemployment benefits.

Give the following information as of the last day of the most recent plan year and enter that date here.

- Total number of employees covered by the plan who are shareholders, officers, self-employed persons, or highly compensated (see instructions for line 3a of Schedule F).
- Number of other employees covered by the plan.
- Number of employees not covered by the plan.
- Total number employed.

*Should equal the total of a, b, and c - if not, explain the difference. Describe the eligibility requirements that prevent those employees not covered by the plan from participating.

At any time after December 31, 1959, did any of the following...
ACKLEY, et.al., Financial Responsibilities of Governing Boards of Colleges and Universities, Assoc. of Governing Boards of Universities and Colleges, Washington, D.C., 1985. This monograph attempts to identify linkages between the financial position and requirements of an institution and its programs, goals and functions to assist board members and trustees in understanding the dynamics of college and university governance. Governance, by definition, requires the exercise of judgement. This exercise, without acceptance of institutional goals and understanding of financial limitations, makes for poor decision making. Judgement necessarily requires value based decision making. Various value based systems are reviewed to provide an ethical base for decisions.

Atkinson, Rob, "Major Legal Topics to be Covered in a Law School Course on Nonprofit Organizations", NYU Conference Proceedings: Research Agenda: Legal Issues Affecting Nonprofit Corporations, New York University, Program on Philanthropy and the Law, 1989. Here a legal scholar pointed out the need for improved training and education on "value-based rules" to "ensure that nonprofits perform their designated purposes and serve their respective constituencies". Currently nonprofits do little or no self-policing. There are, due to the diverse nature of nonprofit organizations and their goals, no broad or general ethical standards governing performance. The author points out the inevitable link between federal tax policy and nonprofit governance and the need for enabling and monitoring legislation on fiduciary standards. He is careful to point out the natural "tension policy makers face between broad good faith standards and narrow per se rules." He suggests that further federal tax legislation could be one way of addressing the general lack of ethical standards.

Boris, Elizabeth, "Philanthropy and the Future", in The Nonprofit Organization: Essential Readings, Gies, Ott and Shafritz (ed.), Brooks Cole, Pacific Grove, CA, 1990. Dr. Boris predicts the future of the sector in this piece which includes lengthy discussion of the "rising concern with ethical conduct". The congruence of internal and external trends affecting the sector will determine, in large part, where the sector goes. There appears to be a growing trend toward increased regulation of nonprofits, much of which will be tax related since nonprofits are defined in large part by the tax law. "A renewed concern with ethics in fundraising, in grantmaking, and in
governance is coming to the fore." Action will be both internal and external to the sector.

Cerney, Milton, "Tax Exempt Organizations: It’s Been a Memorable 20 Years", Tax Notes, Tax Analysts, Washington, D.C., November 12, 1992. A former IRS rulings section chief provides an historical review of the ebb and flow of public opinion and IRS enforcement efforts directed at tax exempt organizations over the last 20 years. He is careful to point out that these organizations have come under scrutiny many times in the past for perceived abuses. "The 'level playing field' became the catchword of those who felt that tax exempt organizations were abusing their preferential tax exempt status." The author concludes that the power and economic force wielded by the sector has grown substantially over the last 20 years and that this has contributed to both scrutiny and scandal.

Cooper, Terry L., The Responsible Administrator: An Approach to Ethics for the Administrative Role, Kennikat Press, Port Washington, New York, 1982. This author believes the cultivation of ethical behavior comes from education and skill development in thinking about ethical problems. Formal study in ethics is encouraged through understanding the role of the public administrator, providing the analytical tools for decision making, as well as the development of "a democratic ethos for public administration." Although directed at the public sector it has significant application to the nonprofit sector particularly in regard to the need for education in roles and tools.

Dayton, Kenneth N., Governance is Governance, Third Sector Press, Washington, D.C., 1988. This booklet is a monograph of a speech presented at the Independent Sector's Professional Forum, hosted by the Effective Sector Leadership/Management Program. It attempts to describe what governance is and is not. It provides suggestions for organization, planning, operations, functions and responsibilities for efficient, effective and ethical management and governance. The author stresses the difference between management and governance pointing out that these are not interchangeable terms and the importance of properly defining the roles of management and trustees to an effective organization.

Drucker, Peter F., Managing the Non-Profit Organization: Practices and Principles, Harper-Collins, New York, 1990. This well respected author emphasizes the vision of the organization as the focus. Attention to the charitable or other exempt purpose of the organization is the key to organizational, individual and ultimately, societal success. If the nonprofit executive is focused on "making a difference" rather than making a name for themselves, making a living or making a killing, the organization has a much better chance for success. Personal accountability and responsibility
replace the need for codes of ethics. The author offers practical advice for persons engaged in management and governance of nonprofit organizations.

Gardner, John W., *The Nature of Leadership*, The Independent Sector, Washington, D.C., 1986. Mr. Gardner attempts to define real leadership and to distinguish it from administrators, manipulators and tyrants. He provides some contexts in which leadership traits often arise, both situational and historical. He describes the exercise of sound moral judgement as the key to true leadership and describes other impediments to effective leadership development including, technical considerations, dispersion, intervening systems, anti-leadership sentiment, and the lack of formal training. Of particular importance is "to be clear in our minds about the moral and ethical criteria for an acceptable leader".

Garofalo, Charles and Geuras, Dean, "The Ethics of Ethics Training", ASPA/CUSA 54th National Training Conference, American Society of Public Administration, San Francisco, July 1993. The authors suggest that there is a dichotomy which exists in education circles concerning the teaching of ethics. One school of thought recommends instruction that produces desirable behavior and moral character while the other proposes that teaching people how to behave and what to think is morally unjustifiable and considers such attempts to be "indoctrination". The authors examine this dichotomy with a view towards recommending an approach they believe will be most effective.

Gaul, Gilbert and Borowski, Neill, "Warehouses of Wealth: The Tax-Free Economy - a series", *The Philadelphia Inquirer*, April 18-24, 1993. This series of articles appearing in a respected Philadelphia newspaper is an indictment of the nonprofit sector. The authors depict nonprofits and the people who run them as greedy, tax evading, money hoarders. The articles include limited evidentiary information and do not reflect any significant empirical study. However, the anecdotal information although not particularly shocking or surprising is nonetheless damaging to the sector. The nonprofit sector is depicted as a "growth industry" which annually deprives the U.S. Treasury of some thirty six billion dollars in forgone tax revenue. Little or no recognition of the benefits provided by the sector is acknowledged. Hospitals, colleges, organized religion, museums and private foundations are all singled out for criticism for becoming too commercialized, too profit oriented and "warehousing wealth". The IRS is also harshly criticized for being too lenient in granting exemptions and for the lack of enforcement. Pay packages and perquisites for top nonprofit executives are examined and concluded to be exorbitant, in large part due the fact that over 1000 nonprofit executives are paid more than the U.S. President. Certainly there are abuses (e.g. William Aramony at the United Way) and these are presumed to be
prima facia evidence against the entire sector. The ready availability of tax exempt bond financings to support expansion and construction by nonprofits and state and local governments is similarly presumed to be harmful to the country through the loss of tax revenues.

Glaser, John S., The United Way Scandal: An Insider's Account of What Went Wrong and Why, John Wiley & Sons, New York, 1993. Essentially an apologetic for the author, the former head of United Way International, and William Aramony, the former President of United Way of America, this insider's account gives little or no insight into what went wrong and why. Perhaps the only new insight on the whole mess is his description of the depths of Mr. Aramony's conceit and that it is this arrogance which contributed greatly to his downfall. It does offer 13 tips for improving nonprofit governance most of which are common sense, unoriginal and simplistic.

Graham, Ellen, "Thin Rewards: Sprawling Bureaucracy Eats Up Most of Profits of Girl Scout Cookies", The Wall Street Journal, May 13, 1993. Even esteemed organizations such as the Girl Scouts have begun to come under scrutiny and criticism. The volunteer effort of Scouting's 2.6 million girls produces some $400 million a year but, only some 14 percent of this actually goes to the individual troops. Most of the profits are kept by the 332 regional councils who together spend some $357 million a year mainly on salaries and benefits for regional "policy enforcers" and supervisors. "The sales machine needed to sustain this vast administrative apparatus, critics suggest, has come to overshadow scouting's philanthropic mission." Girl Scouts is criticized for getting too big and too bureaucratic.

Hall, Peter D., "The Best of Times; The Worst of Times: A Report on the State of Nonprofits Research", Philanthropy Monthly, Nonprofit Report Inc., New Milford, CT, December, 1992. The author, one well known to nonprofit circles, reviews the progress of research on issues affecting nonprofits over the last two decades and finds it lacking. While some new journals, organizations, and academic centers have arisen to fill the gap, it has not been enough. He also expresses concern that these achievements have been funded with "soft dollars" and that few, if any, of these efforts are sufficiently funded to continue for very many more years. There may even be a "coming crisis" in nonprofit research in the coming years due to the growth in the sector; the scandals of recent years indicating a breakdown in morals and ethics; state regulation; the aggressiveness of advocacy groups; and federal tax reform. Part of the agenda for the 90s includes needed changes to federal tax law to distinguish between charitable and noncharitable exempt organizations; organization of the sector to combat creeping taxation by the states and municipalities; a shift away from
managerial governance slant; and evaluation of value based standards for trustees before regulation mandates rules controlling self dealing and conflict of interest situations.

Hansmann, Henry B., "The Evolving Law of Nonprofit Organizations: Do Current Trends Make Good Policy?", 39 Case Western Reserve Law Review 807, 1989. In this article Professor Hansmann suggests that the best way to proceed in reviewing justification for exempt status is to systematically begin to withdraw it through legislation on an "industry by industry" basis. For instance, in 1986 exemption was withdrawn from nonprofit insurance companies, including health insurers. More aggressive enforcement of the federal tax law must occur in order to fix what appears to be wrong with the nonprofit sector. If some very compelling justification for exemption isn't offered government should proceed promptly to withdraw it.

Harris, Holley and McCaffrey, Fundraising into the 1990s: State Regulation of Charitable Solicitation after "Riley", New York University School of Law, 1989. This commentary examines the litigation surrounding charitable solicitation regulation by describing probable permissible and impermissible or unconstitutional regulation. Charitable solicitation has become big business ($100 billion in 1988 was received by charities) and with this growth has come abuses, illegal and unethical campaigns, and unscrupulous fundraisers. Some excellent legal analysis of recent litigation on these issues is provided most particularly of the Supreme Court's decision in Riley. Some of the restrictions and regulations which will most likely be imposed on most charities in the near future include pre-, point-of, and post-solicitation disclosures to donors; mandated content for disclosures; financial statement disclosures; licensing and other measures. These actions, although instrusive on the activities of private corporations are deemed necessary to prevent abuse and protect the citizenry.

Heller, Trudy, "Changing Authority Patterns: A Cultural Perspective", Academy of Management Review, 10:489, 1985. Heller has described authority as being "in crisis" in the U.S. due to cultural and societal changes toward a slipping morality, increased greed and selfishness. The public's trust in the voluntary nonprofit and government sectors have been shaken to the core. The lack of loyalty toward business and government organizations which arose after the second World War stems from the less hierarchical authority patterns which have been experimented with since that time, as well as scandal in those sectors. Cultural orientation can have significant impact on institutional systems and will have considerable negative impact on the nonprofit sector in the near future.
Jackson, George, "The Role of the Judiciary in Federal Tax Policy", Tax Notes, Tax Analysts, Washington, D.C., May 10, 1993. This article presents a basic explanation of judicial review as a part of the policy process. Although primarily directed toward the imposition of excise taxes and their administration, the article offers insights into the legal arguments and standards applied to differing issues and types of cases. It succinctly explains the difference between the "rational basis" test which tends to put the judiciary in a position subservient to Congress and the more stringent "compelling state interest" and "balancing doctrine" tests which come into play whenever a fundamental freedom appears to be endangered. These tests clearly place the judiciary in a position superior to Congress.

Jeavons, Thomas H., "When the Management is the Message: Relating Values to Management Practice for Nonprofit Organizations", Nonprofit Management & Leadership, Jossey-Bass, San Francisco, Vol. 2, No. 4, Summer 1992. Jeavons makes an important distinction about the nature of nonprofit organizations, that unlike business and government organizations, the nonprofit sector has its roots in religious moral and ethical values. Those nonprofits who serve their own members, such as business, trade, agricultural, advocacy, veteran's and fraternal organizations were acknowledged as probable exceptions to this generalization about the roots of the sector. These values are expressed by the organizations in their organizational purposes, missions, policies and procedures. Perhaps because of the very nature of these entities, the public seems to have higher moral expectations for charitable organizations than business and government. "(W)e fully expect—even demand—a higher level of integrity from charitable or philanthropic organizations. We tend to believe both that they will and that they should operate with different values and that greater integrity in their operation is something that we have a right to expect." This value base requires new and different management styles that respond to societal demands for a higher moral and ethical performance from charities.

Joseph, James A., "The Case for Foundations", Foundation News, Council on Foundations, Washington, D.C., July/Aug. 1993. Mr. Joseph, the President of the Council on Foundations, responded to the Philadelphia Inquirer series of articles which generally criticized the activities of nonprofits. He expresses great concern about some of the misleading aspects of the series, particularly the confusion apparent between the terms "tax exemption" and "charity". "Tax exemption is not synonymous with charity. In fact, 24 of the 25 categories of tax exempt organizations under U.S. law are not charitable groups at all. Their objectives and their behavior should not be confused with the many acts of compassion and the practices of philanthropy...." While he acknowledges there have been abuses, he makes a strong case that given the size of
the sector the abuses are not significant in number or magnitude. The Philadelphia Inquirer series described numerous abuses by these other groups.

Moody, Lizabeth A., "Nonprofit Organizations: Organizational Form and Structure", in NYU Conference Proceedings, supra, 1989. The author points out that little thought has been given to whether or not existing federal and state tax law affecting charitable organizations is really able to accommodate "the legitimate and commendable operations of vast numbers of these operations." She suggests the law has been permeated with organizational concepts which apply more appropriately to business organizations and that the structures imposed on charitable organizations are derived from these structures which may in many instances be wholly ineffective. The author goes on to try to identify those nontax factors affecting nonprofits which often dictate their organizational structure; identify alternatives to traditional structures; question whether or not such alternative structures are workable under present law; and suggest a need for statutory reform.

Nutt, Paul C., and Backoff, Robert W., Strategic Management of Public and Third Sector Organizations, Jossey-Bass, San Francisco, 1992. This effort is designed as a handbook for leaders of these organizations to adapt forprofit sector strategic planning and management techniques to government and nonprofits. Although primarily focused on "how to" it provides some excellent discussion of innovation and the importance of the mission to both government and nonbusiness entities. It describes some of the challenges that these entities face which are unique to their sectors and how to overcome those obstacles. The authors use what they call "issue tension" to describe the opposing moral, ethical and cultural forces pulling these organizations in several directions at once and how to deal with this tension.

Odendahl, Teresa, (ed.), America's Wealthy and the Future of Foundations, The Foundation Center, 1987. Any examination of philanthropy and charity necessarily requires an understanding of America's persons of wealth and their goals and motivations for sharing that wealth. Such an examination will immediately serve to illuminate both the potential and limits of private philanthropy. New leaders and new private foundations will be needed to meet the needs of society and its unclear where these leaders will come from. This ambitious work is actually a compilation of studies and essays by a number of mostly well known nonprofit scholars, researchers and practitioners. It includes an analysis of the private foundation's place in the nonprofit sector; an historical review of the creation and growth of foundations; giving patterns
of the wealthy; and wealthy donors' attitudes toward charity. It provides insight into the probity of charity and the incentives it offers the rich.

Odendahl, Teresa and Boris, Elizabeth T., "Ethical Issues in Fundraising and Philanthropy", in Critical Issues in American Philanthropy, Van Til and Associates, Jossey-Bass, San Francisco, 1990. Just one chapter in a compendium of fine articles on the state of the sector, this essay nonetheless has a great deal to say about the nature and status of ethics in the nonprofit sector. It makes the very important point that "...in a basic sense, ethics is a concern with choices and operates beyond the realm of the law..." , which is to say you can't legislate morality. It does not concern itself with trying to develop standards or in evaluating existing standards but, rather the rationale and basis for ethical standards. They point to accountability as the overarching issue in ethical considerations, encouraging nonprofits to be more open in their communications and to share both their successes and failures.

O'Neill, Michael, "Ethical Dimensions of Nonprofit Administration", Nonprofit Management & Leadership, Jossey-Bass, San Francisco, Vol. 3, No. 2, Winter 1992. This author argues that executive responsibility is perhaps the most important aspect of management. Although these responsibilities are similar regardless of the sector, there are some unique moral and ethical considerations which make the nonprofit sector different. The author expresses dismay about the lack of training and education nonprofit managers have in managerial ethics and that more is not known about the ethical dimensions and motivations of nonprofits despite the importance that ethical considerations have to the sector. He makes an "urgent" plea for significant additional study. "Given the nonprofit sector's historical involvement and interest in ethical issues, it is somewhat startling...to see the extensive and often high-quality work that has gone into business and government ethics and then find virtually nothing on nonprofit ethics." He briefly discusses the case study approach to studying ethics and calls for more rigorous types as well.

Ostrowski, Michael R., "Nonprofit Boards of Directors", in The Nonprofit Organization: Essential Readings, supra, 1990. This author lays out what he, and I suspect many others, believes to be the five general responsibilities of nonprofit board members. These attitudes, as the author indicates, have come in large part from the corporate sector, however, therein lies the problem with these general responsibilities and they are the source of much of the current criticism of the sector. For instance, the first general responsibility is described as loyalty to the nonprofit organization, an obligation to act in the best interest of the organization at the exclusion of personal gain. A more informed view would be loyalty to higher purposes; that is the accomplishment of some charitable purpose without regard for what actions best serve
the nonprofit organization itself. The second general responsibility involves business dealings between the board members and the organization. The essay implies these business dealings are acceptable if there is full disclosure and fair, open process in awarding the contract. Once again, a more informed approach would be to avoid even the appearance of any impropriety by prohibiting such actions as many states require. The essay provides therefore, what is merely the conventional thinking about nonprofit governance and can be used as a roadmap for developing a more comprehensive standard.

Pearlman, Ronald, "The Tax Legislative Process: 1972-1992", Tax Notes, Tax Analysts, Washington, D.C., November 12, 1992. The author reviews the changes to the tax legislative process over the last twenty years it appears, primarily for the purpose of criticizing the process. The explosion in the volume and complexity may be explained by the proliferation of tax lawyers and accountants; the deficit and budget process including the Budget Act of 1974 and the Gramm-Rudman Act; the changing role of the Administration and the Treasury Department; the size of the tax writing committees; and the turnover in leadership. The author likens the process to "watching sausages being made".

Plant, Jeremy F., "Codes of Ethics in Public Administration", ASPA/CASU 54th National Training Conference, American Society for Public Administration, San Francisco, July 1993. Although codes of ethics have been around for more than fifty years they have been largely ineffective in positively changing behavior. There is a significant contemporary debate surrounding codes of ethics and their usefulness. The author suggests that professional associations offer the greatest opportunity for developing acceptable and workable codes of ethics for public administrators, yet admits the failures of such codes in the past. He attributes these failings to "ambiguity over the purpose and meaning of codes". He suggests and defines the three types: "written collections of laws; a system of morally binding rules; and a system of symbols facilitating communications". A form of public oath may be what is needed to move to a higher level of ethical behavior.

Pops, Gerald M., and Pavlak, Thomas J., The Case for Justice: Strengthening Decision Making and Policy in Public Administration, Jossey-Bass, San Francisco, 1991. The authors make a case for the adoption of a new value-based decision making process. They argue that "justice" is a universally shared value that can be easily understood and integrated into administrative decision making thus, better serving the public interest. Although primarily directed at public administrators, the concept of administrative justice may be adapted to many nonprofit organizations and situations. An emphasis on administrative justice, they believe, will contribute to less finger
pointing, less bureaucracy, fewer complaints, fewer lawsuits and happier constituents. Of course the adoption of such a notion requires the administrator to be given a certain level of administrative discretion, a luxury that is not always readily available. The book seeks not only to make a case for justice but to train managers in some of the concepts necessary to implementation of such a program.

Rubin, Hank, "Dimensions of Institutional Ethics: A Framework for Interpreting the Ethical Context of the Nonprofit Sector", in Gies, Ott and Shafritz, The Nonprofit Organization: Essential Readings, supra., 1990. According to this author bad things can happen to good organizations when one of these three phenomena occurs: "the presence of people drawn to the sector by nonaltruistic motives, the acquiescence of deluded altruists to self-serving temptations, and the presumption of some in the sector that unethical means may be justified by altruistic ends." The author describes the "legal" and "normative" dimensions of nonprofit ethics as well as the "administrative" and "technical". He then provides a proposed model for ethics and accountability for the nonprofit sector. The model is quite developed and could be useful on an organization by organization basis but, probably not sector wide due to the large diversity in types of nonprofit organizations.

Slocumbe, Walter, "Charities and Federal Taxes: Issues for Analysis, in NYU Conference Proceedings, supra, 1989. This author suggests several practical topics which he believes should be included in any comprehensive agenda for research on legal issues affecting charities including: the rationale for and utility of tax exempt status; contribution/deduction rules; private inurement most particularly compensation and self dealing with insiders; the scope of activities eligible for exemption; the accumulation of wealth and economic power by pension funds and certain charities; other tax rules; private versus public charity status; the role of charities in the public policy debate; the IRS as enforcer; unrelated business income tax issues; transitions into and out of exempt status; and constitutional issues. Some excellent discussion about each of these issues and their importance to the future of the charitable sector is provided.

Smith, David H., "Moral Responsibilities of Trustees", Nonprofit Management & Leadership, Jossey-Bass, San Francisco, Vol. 2, No. 4, Summer 1992. While most articles or research on the issue of nonprofit governance focus upon the managerial or social science aspects, this essay looks more heavily at the moral responsibilities of trustees. Trusteeship or governance based on moral grounds is seen as having greater prospects for success, in a qualitative not quantitative sense. Detractors of trusteeship say it is undemocratic and paternalistic and thus, is internally flawed from a moral
viewpoint. These are conclusions that outsiders may draw when they are not patrons of the organization. But, those the nonprofit serves, its donors, founders, patients, students and other constituents more often do not reach the same conclusions. It then is reduced to a question of perspective not quality. The ability to create private organizations to serve the public good appears to be uniquely democratic, and although America didn't invent philanthropy, it certainly has come of age under democracy. It is further suggested that trustees give thought to serving the greater good even if that action is detrimental to their own organization in the long run.

Smith, Robert W., "Ethics Commissions, Inspectors General and Ombudsmen: A Discussion of Ethics, Accountability and Democracy in the States", Proceedings of the ASPA/CASU 54th National Training Conference, American Society for Public Administration, San Francisco, July, 1993. This paper examines the current state of ethics around the U.S. and the general public's acceptance of the inevitability of failings. The author believes these failings can be avoided through the use of ethics commissions, inspector generals and ombudsmen and that the general state of ethics and accountability can be improved through a "systems approach". There appears to have been little serious discussion or research about existing institutional mechanisms and their ineffectiveness in positively affecting ethics and accountability. The prevalence of unethical and illegal behavior is seen as widespread including elected politicians, appointed state and local government personnel, criminal justice personnel, university personnel and numerous others.

Streckfus, Paul and Jakubowicz, Peter, "Oversight Panel's Hearing on Charities Was Worth the Wait", Tax Notes, Tax Analysts, Washington, D.C., August 9, 1993. The authors summarize the findings of the House Ways and Means Subcommittee on Oversight's second public hearing on the activities of tax exempt public charities. Although there were some exceptional abuses reported they were described as clearly the exception and not the norm. This was even acknowledged by Chairman Pickle, one of the sector's most adamant detractors. He indicated it was his goal to see that the valuable activities of most charities were not "tarnished by the bad acts of a few". The IRS' testimony indicated however, that the problem is getting worse and the lack of funding and qualified agents has hampered the Service's enforcement and audit efforts. Others testifying, including Connecticut's attorney general, felt that "fraud and chicanery by those acting in the name of charity is disturbingly common."

American charities into an unrestrained economic storehouse has occurred without notice, forethought, or national debate..., Mr. Suhrke points out that few charities outside of religion, health care, higher education and private foundations have any significant assets and that there have been no less than a dozen Congressional hearings concerned with charities. He criticizes the series for emphasizing the theme that individuals must pay higher taxes because these organizations are tax exempt. Even the authors' criticism of the IRS is misdirected as they clearly do not understand that the Service concentrates its efforts in areas where the greatest payoffs in terms of additional taxes are, which is not the nonprofit field but individuals and corporations. One of the biggest misrepresentations of the series is the failure to distinguish between noncharitable nonprofits and charities. The abuses and lobbying efforts of the noncharitable nonprofits are attributed to all. Mr. Suhrke also provides a discussion of the necessity and content for an appropriate response. Philanthropy needs to take a more proactive role in communicating with the public about its successes and failures.

Suhrke, Henry, "The Image of Nonprofits and Their Financial Statements", The Philanthropy Monthly, Vol. XXVI, No. 1, Jan./Feb. 1993. "One of the most egregious errors of the Philadelphia Inquirer's expose...concerns the profit margins the author of the series has calculated for not-for-profit organizations." It is pointed out that nonprofit financial results and financial statements are not directly comparable to those for taxable entities and that nonprofits reasons for producing surpluses are different than forprofit entities' reasons. The author describes the efforts of the Financial Accounting Standards Board since 1986 to come up with comprehensive and effective reporting standards for nonprofit organizations which would at least make them comparable to one another. Of particular importance, at least since the United Way scandal, is the question of whether or not to include the results of operations for financially interrelated entities in the financial statements of nonprofits. A draft summary of the FASB proposal including flowcharts for determining interrelatedness is provided.

Suhrke, Henry,(ed.), "What Congressman Pickle Wants", The Philanthropy Monthly, Vol. XXVI, No. 2, March 1993. The present chairman of the House Ways and Means Committee, a key member of the tax writing committee of the U.S. Congress has called for extensive new legislation affecting nonprofits: "I intend to introduce legislation which would: establish intermediate sanctions, such as a five percent excise tax, applicable to organizations and individuals for acts of inurement, private benefit, self-dealing, and unreasonable compensation; establish a reasonable compensation limitation which would apply unless the organization's payment of a larger amount was pre-approved by IRS; provide IRS with authority to grant tax-exemption for limited periods of time, such as three, five or ten years; require that the Form 990 provide a
section in which an organization would need to report governmental actions, including the payment of additional taxes for self-dealing, prohibited political activity, excessive lobbying, and unreported unrelated business income; and provide for additional public access to the Form 990." Congressman Pickle is criticized for pandering to perceptions of abuse by nonprofits without bothering "to learn if those perceptions are factual or not." Viewpoints on the Pickle proposals are provided by the IRS, the Evangelical Council for Financial Accountability, Council of Better Business Bureaus, and the National Charities Information Bureau. Each and every witness who testified before Ways and Means found Mr. Pickle's package of proposals unnecessary and/or unworkable.

Suhrke, Henry C., "Pickle Act II: Charging Charity Abuse Gathering Momentum", Philanthropy Monthly, Nonprofit Report Inc., New Milford, CT, Vol. XXVI, No. 3, April, 1993. The author reviews the second Congressional hearing on changes Congressman Pickle wants to make in taxation and legal regulation of charities citing substantial abuse of existing laws. New law is seen as necessary because of the great diversity in nature and type these organizations take. New tax law is seen as perhaps the only way to affect a positive change on this very large and amorphous sector. Discussions centered around "intermediate sanctions". Existing law requires revocation of exemption for violations involving inurement, personal benefit, self dealing and unreasonable compensation. Recommendations are being presented for fines or penalties for acts of these types rather than the more severe revocation of status. The author points out that many of the proposals are more appropriately aimed at noncharitable exempt organizations and that there is a great deal of confusion and "misplaced concern" over certain activities undertaken by these other exempt organizations. However, Chairman Pickle seems to believe that charities are most at fault and is pressing for legislative action.

Van Til, John, Mapping the Third Sector: Voluntarism in a Changing Social Economy, The Foundation Center, 1988. One of the most respected nonprofit sector scientists provides us here with reviews of both the historical and contemporary models of the nonprofit sector. He emphasizes the need to eliminate sectoral boundaries and think more multi-dimensionally about what he calls voluntary action agencies. He describes much of what most would agree is the future agenda for the sector and provides excellent discussion and insight into the direction of future inquiry about the sector. The inter-relationships between the sectors and the unique position of the voluntary sector is analyzed in great detail. He describes the sector as morally threadbare and in need of reinventing itself in ways which emphasize the idealism and "habits of the heart" responsible for creation of the sector in the first place. In short
the sector is described as the "sustenance of modern society" and its health essential to maintaining the moral fabric of our culture.

Van Til and Associates, Critical Issues in American Philanthropy, supra, 1990. Dr. Van Til brings together a number of respected authors and scholars to describe the present state of the nonprofit sector. Its historical context, its context in present society and the need to improve the sector are the book's three major topics. In the latter numerous legal, ethical and governance issues are reviewed with the idea of improving the future for the sector and ultimately for society at large. It is hoped the sector can become a more "active" than "reactive" force. Philanthropy is seen as being at a critical junction, surrounded by scandal both real and perceived, plagued by misinformation and misguided motives, beset by state, local and federal tax authorities looking for new sources of revenue and questioning itself and its ability to deal with seemingly insurmountable societal problems.

Williams, Grant, "For Charities, a New Taxing Problem", Chronicle of Philanthropy, May 18, 1993. Exemptions are being ignored by many state and local governments hungry for new sources of revenue to satisfy strained budgets. "Incursions on nonprofit tax exemptions are like kudzu down in the South: they're growing like mad all over the place." A Washington lawyer who monitors state tax trends for a number of charitable groups was recently commissioned to do a comprehensive study on state sales tax trends. There appears to be a wide variety of applicability of these tax rules to nonprofits. Because of the many taxing authorities involved its difficult to keep up with changes.