

The Dual Subsidy Theory of Charitable Deductions

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Americans contribute billions of dollars to charities on an annual basis. Charitable contributions not only represent American generosity, they also represent a form of giving that provides donors with tax relief. The current literature on charitable contributions suggests that this relief plays an important role not only in decentralizing the provision of public goods, but also in helping the nonprofit sector provide public goods more efficiently than government spending. Even if these claims were indisputable, they are insufficient to justify the current scheme’s antidemocratic function. This Article argues that, at their core, tax-subsidized contributions are part of a nondemocratic mechanism that allows individual donors to direct public funds while bypassing majority approval. Despite the nondemocratic attributes of charitable spending, this Article recognizes the virtue of charitable spending in voicing preferences not accounted for by the majoritarian process. Therefore, while the current literature suggests that charitable tax relief represents a substance subsidy—by promoting the allocation of resources toward a confined set of legislatively

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enumerated public goods—this Article argues that it is also a process subsidy that supplements the shortcomings of majority decision making. This dual subsidy approach leads to the inevitable conclusion that the current U.S. charitable tax relief scheme undermines the integrity of the majoritarian process, because it disproportionately subsidizes the process component of affluent taxpayers. To better reconcile with democratic theory, many of the scheme’s attributes—for example, tax subsidies to corporate philanthropy—should be reconsidered and restructured. In raising this point, this Article opens a broader debate about the proper role of majority decision making and efficiency claims in legitimizing democratic tax and spending decisions.

INTRODUCTION

What do extracurricular activities in public schools, memberships to art museums and zoos, free corporate events in public parks, university libraries and research facilities, overpriced tickets to fundraising events, and sponsorship ads in college-league games all have in common? They are often financed through tax-deductible payments characterized as charitable contributions. This is only the tip of the iceberg—the fundraising industry is booming, pushing against conventional notions of “Good Samaritan” charity in an attempt to make as much of our lives deductible. To date, the Treasury Department projects to forfeit about \$324 billion in income tax revenues for fiscal years 2008–12 due to charitable deductions.¹ Rather than evaluating the merits of specific contributions, this Article examines the overall democratic justification for charitable tax relief.

People without tax policy experience may fail to see this forfeiture of tax revenues for what it essentially is—an indirect governmental subsidy to nonprofit charitable organizations (NPOs). To promote philanthropic giving, almost all Western countries grant some type of income tax relief for charities (hereinafter “charitable relief”).² Charitable relief is a political mechanism that shifts some of the authority and responsibility of allocating public funds from the majority decision-making process to individual donors. Through their charitable contributions, donors allocate public funds based on their own preferences, thus requiring the majority—through the government—to modify its tax-spending decisions to compensate for the revenue loss. This allocation of public funds differs fundamentally from the canonic democratic way of reaching spending decisions through majority voting and coalition building. Despite the global popularity of providing charitable relief, academics and policymakers have failed to explicitly recognize and normatively defend this circumvention of majority

1. See OFFICE OF MGMT. & BUDGET, ANALYTICAL PERSPECTIVES: BUDGET OF THE UNITED STATES GOVERNMENT FISCAL YEAR 2008, at 296 (2007) [hereinafter OMB REPORT]. There are no clear, current estimates for the amounts of estate tax expected to be forfeited on the account of the charitable deduction in fiscal year 2008.

2. See generally LESTER M. SALAMON, THE INTERNATIONAL GUIDE TO NONPROFIT LAW (1997) (providing an overview of twenty-two countries, of which only Sweden does not provide any charitable relief for charitable contributions); J. Mark Davidson Schuster, *Tax Incentives for Charitable Donations: Deeds of Covenant and Charitable Contribution Deductions*, 19 U.S.F. L. REV. 329 (1985) (explaining the development of the United Kingdom’s deed of covenant charitable relief).

approval. This deficiency raises questions about the compatibility of providing charitable relief through donor-directed mechanisms with basic notions of democratic theory. This Article aims to mitigate this deficiency by offering a novel justification for charitable relief.

In the United States, Congress introduced charitable relief eighty years ago, at approximately the same time as the income tax,³ in order to mitigate the risk that the (then) new income taxes would “squeeze out” private giving to charities that provided essential public services.⁴ This underlying agenda has not significantly changed and, as a result, charitable relief largely retains the same structure.⁵ What has changed, however, is reality. As taxpayers increasingly use charitable relief to deduct expenses distant from what have been considered traditional forms of charity, revenue costs will continue to soar, forcing to the surface questions of its political legitimacy.

3. See Ellen P. Aprill, *Churches, Politics, and the Charitable Contribution Deduction*, 42 B.C. L. REV. 843, 849 (2001); John D. Colombo, *The Marketing of Philanthropy and the Charitable Contributions Deduction: Integrating Theories for the Deduction and Tax Exemption*, 36 WAKE FOREST L. REV. 657, 682–85 (2001); John G. Simon, Harvey Dale & Laura Chisolm, *The Federal Tax Treatment of Charitable Organizations*, in THE NON-PROFIT SECTOR 267, 275 (Walter W. Powell & Richard Steinberg eds., 2d ed. 2006). Charitable relief for corporate contributions was introduced along with the corporate income tax. See Miranda Perry Fleisher, *Generous to a Fault? Fair Shares and Charitable Giving*, 93 MINN. L. REV. 165, 170 (2008) (“A charitable deduction has been part of the income tax since 1917.”).

4. See David B. Lawrence & Massoud M. Saghafi, *The Flat-Rate Income Tax, Tax Burden, and Charitable Contributions*, 37 NAT’L TAX J. 569, 569–73 (1984) (stating that a different tax policy toward charitable relief would also require a change in expenditure policy); Simon et al., *supra* note 3, at 275; Peter J. Wiedenbeck, *Charitable Contributions a Policy Perspective*, 50 MO. L. REV. 85, 93–95 (1985).

5. The charitable relief agenda was somewhat ossified in the 1980s and 1990s by the privatization and deregulation trends, which followed the belief that NPOs and not government should be the direct provider of many public goods. See Jessica A. Cohen, *Ten Years of Leftovers with Many Hungry Still Left Over: A Decade of Donations Under the Bill Emerson Good Samaritan Food Donation Act*, 5 SEATTLE J. FOR SOC. JUST. 455, 460–64 (2006) (arguing that the Good Samaritan Food Donation Act led to the withdrawal of the government from assuring food security); Faith Stevelman Kahn, *Law, Culture, Education, and Politics*, 41 N.Y.L. SCH. L. REV. 753, 753 (1997). However, the United States and other Western governments maintained charitable relief even during the 1960s and 1970s when governments were expanding and when they increased social and welfare spending. The decision to maintain both may seem somewhat confusing. Charitable contribution tax relief reduces the revenues that governments need to increase their centralized expenditure programs. Providing tax relief during a time when the government’s objective is to increase its responsibility for social spending programs seems to be contradictory. See Burton A. Abrams & Mark D. Schmitz, *The Crowding-Out Effect of Governmental Transfers on Private Charitable Contributions: Cross-Section Evidence*, 37 NAT’L TAX J. 563 (1984) (providing an elaborate analysis demonstrating the complicated interrelationship between governmental spending and private philanthropy); Douglas Dillon, *The Role of Private Philanthropy in Modern American Society*, TAX POL’Y, Jan. 1972, at 3, 3–5 (explaining that even though government was, at the time, taking responsibility for what once was thought of as the social role of charity, philanthropy was still essential because it promoted local level innovative enterprises essential for the promotion of communal self-help); Jerald Schiff, *Does Government Spending Crowd Out Charitable Contributions?*, 38 NAT’L TAX J. 535 (1985).

Charitable relief has attracted significant attention from academics who have attempted to justify its continued use.⁶ These justifications fall primarily along two different strands of thought. The first and predominant strand argues that charity merits charitable relief because it encourages more and/or better spending on public goods. This justification reflects the current orthodoxy with regard to charitable relief and has been embraced by an array of distinguished scholars writing in the field today, including Evelyn Brody, John Colombo, and Mark Gergen.⁷ This approach relies on two theoretical pillars. The first is that some public goods require more spending than what is provided to them by the tax-spending process. One may think of this justification as the claim that, without more funding, these goods will not be supplied at a socially optimal level. The second is that charitable relief results in a transfer of funds that efficiently promotes public good; advocates of this theory rely on the presumption that spending by NPOs is in many cases more efficient than government spending.

The second strand was developed by Saul Levmore, who argued that charitable relief is desirable because it allows taxpayers to vote with their dollars and to express their preferences over the proper allocation of public goods in society.⁸ Viewed in this light, charitable relief can be justified as an efficient “government-free” public spending mechanism that allows taxpayers to speak while avoiding the bureaucratic shortcoming of government spending.⁹ Because of its focus on individual preferences and voices, people understand this approach as justifying charitable relief because it promotes a more defused and pluralistic way of spending public funds.¹⁰

In this Article, I build upon these two main strands of thought justifying charitable relief. On their own, I argue that both types of justifications offer sophisticated, intuitively compelling, but materially incomplete accounts for charitable relief. Both explain why donor-directed charitable relief supplements the government’s allocation of resources, but they also ignore the fact that charitable relief promotes a nondemocratic decision-making process for allocating public money. Rather than deciding the allocation of public funds through majoritarian decision-making processes, charitable relief allows individuals to decide how to allocate a share of public resources at the expense of the majority. Perhaps because the rules regulating charitable relief were approved by the majority, both justifications presume that this

6. David E. Pozen, *Remapping the Charitable Deduction*, 39 CONN. L. REV. 531, 533 (2006).

7. See, e.g., Evelyn Brody, *Charities in Tax Reform: Threats to Subsidies Overt and Covert*, 66 TENN. L. REV. 687 (1999); Colombo, *supra* note 3; Mark P. Gergen, *The Case for a Charitable Contributions Deduction*, 74 VA. L. REV. 1393 (1988); David M. Schizer, *Subsidizing Charitable Contributions: Incentives, Information and the Private Pursuit of Public Goals*, (Columbia Law Sch. Ctr. for Law & Econ. Studies, Working Paper No. 327, 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1097644; Simon et al., *supra* note 3, at 274–75. This approach also echoes in the Supreme Court’s jurisprudence. See *Bob Jones Univ. v. United States*, 461 U.S. 574 (1983); *Regan v. Taxation with Representation*, 461 U.S. 540, 544 (1983).

8. See Saul Levmore, *Taxes as Ballots*, 65 U. CHI. L. REV. 387, 387–89 (1998).

9. Nancy C. Staudt, *Taxation Without Representation*, 55 TAX L. REV. 555, 572–73 (2002) (providing a good summary of this approach).

10. Johnny Rex Buckles, *The Case for the Taxpaying Good Samaritan: Deducting Earmarked Transfers to Charity Under Federal Income Tax Law, Theory and Policy*, 70 FORDHAM L. REV. 1243, 1286, 1314 (2002); Wiedenbeck, *supra* note 4, at 96–97.

nondemocratic practice resonates with the democratic framework in which it operates. However, majority approval is a necessary, but not sufficient, guarantee to the democratic legitimacy of legal rules. The majority can approve many democratically illegitimate rules—for example, a rule granting every Ivy League graduate two votes in presidential elections. Similar to the multiple voting rule, charitable relief grants some (typically affluent) taxpayers a disproportionate ability to influence public tax-spending decisions.

Both of the existing justifications for charitable relief fail to address its democratic shortcoming. Moreover, they both fail to recognize that policymakers cannot structure a proper relief scheme without first directly addressing the political constraints that a legitimate scheme should adhere to. This results in vagueness about the proper scope of charitable relief, which obviously helps sophisticated taxpayers, who know how to best utilize tax law ambiguities to avoid taxes. However, more than revenue is at stake. First, theoretical opacity surrounding justifications for charitable relief allows policymakers to design charitable relief schemes in ways that are arguably antidemocratic. Second, it indicates a conceptual haziness about the role of efficiency claims in legitimizing spending decisions in a democracy—a problem endemic to much of legal scholarship today.

My main argument is that current orthodoxy is flawed. The notion it promotes is a consequentialist claim that more investment in public good is desirable and that NPOs can efficiently provide these investments. However, this notion is silent to the basic question of when government—representing the majority—should delegate decisions over the size and allocation of the public budget to individual donors. I argue that charitable relief's core justification should address this question; and, moreover, that charitable relief's justification can help refine the democratic spending process in a way that corrects some of the majoritarian process's serious imperfections. Even though the scheme for providing charitable relief is a *nondemocratic* mechanism, this Article argues that a properly designed scheme can remedy the crudeness of the democratic decision-making process without promoting an *antidemocratic* function. Adherence to fundamental majority decision making is only one of many principles behind public spending, and the need for charitable relief justifies a deviation from this principle because it can be designed without undermining the integrity of majority decision making.

My argument develops in the following manner: First, I argue that the current orthodoxy, which justifies charitable relief as providing more or better spending, is indefensible. To justify charitable relief on these grounds—which I refer to as substance-subsidy justifications—one has to show that charitable relief results in desirable effects that government could not achieve through direct spending. I challenge this approach on both factual and theoretical grounds. My critique suggests that there is no one “optimal” way to supply a set of agreed upon public goods, and that there is no way of determining what goods are indeed undersupplied. Without a focal point of “good spending,” policymakers cannot determine whether some goods are indeed undersupplied and whether a donor-directed charitable relief scheme helps to provide them at a more optimal level. Thus, the substance-subsidy justification's core underlying premise is tenuous. I further show that even given such a focal point, it is still questionable whether charitable relief promotes more or better spending on charitable objectives.

Rejecting the prevailing notion, I argue that charitable contributions have a participatory value, and that charitable relief's justification is anchored upon this

aspect of contributions. This participatory aspect allows the charitable relief scheme to somewhat remedy a few of the democratic spending process's vital imperfections, such as the inability to voice and address a wide variety of spending preferences. Despite this participatory value, charitable relief is still a nondemocratic mechanism for allocating public funds and therefore could be justified in a democratic polity only under very stringent conditions. To not undermine the democratic process, charitable relief must be: (1) distributed equally and (2) capped quantitatively and qualitatively so that it can modify, but not countermand, the majority's spending decisions.

The Article points out that these qualitative restrictions resemble the substance-subsidy justification, which requires that contributions be spent on promoting certain types of broadly defined public goods. Therefore, charitable relief is best understood as a dual subsidy for process and for substance. The primary justification for it is that the contribution process itself requires subsidy because it provides an appropriate measure of nonmajoritarian spending. However, the democratic appropriateness of this mechanism is contingent upon its prudent use, which in turn requires confining charitable relief to contributions that promote substance-subsidy objectives. By incorporating both the substance-subsidy and process rationales, my argument not only advances a novel participatory aspect of charitable relief, but also demonstrates how charitable relief—which is a nondemocratic practice—may remain within the legitimate framework of democratic theory.

The lack of a comprehensive theory that justifies charitable relief amounts to more than an academic deficiency in democratic theory. The unavoidable conclusion of my analysis is that the U.S. income tax charitable relief scheme is materially flawed and in need of a major reform. Tax law, however, develops frequently through incremental changes rather than through fundamental reforms. Therefore, to substantiate the analysis's contribution, I extend its conclusions to try and generate a policy framework to better understand and resolve real-world problems within the structure of existing law.

This dual subsidy framework systematizes how policymakers and academics should interpret current charitable relief legislation. It provides policymakers with an analytic tool that helps determine whether certain contributions should qualify for charitable relief. It suggests that, where either the process or substance strand is questionable, charitable relief's validity becomes tenuous. In the rapidly changing landscape of philanthropy, this policy tool is important. To successfully confront professional fundraisers' attempts to broaden charitable relief's scope, tax authorities must have a comprehensive theoretical framework as a baseline for a coherent policy. This Article provides two contemporary case studies in which its dual analysis is tested and evaluated: contributions made by corporations, and contributions to religious NPOs engaged in partisan political activity. Granting charitable relief in both cases is controversial because the process aspect is not met in the case of corporate philanthropy, and the substantive aspect is not met with regards to religious NPOs.

These two case studies provide a concrete example of what I consider to be the unavoidable conclusion emerging from this analysis: that much of the scholarship and legal arrangements related to charitable relief should be reconsidered. In writing this Article, I also hope to open a broader debate concerning the conditions to which the proponents of nondemocratic mechanisms—such as donor-directed charitable relief schemes—must subscribe to in order to avoid contradicting democratic rationales. This aspect is frequently overlooked by existing literature, especially in the context of advocating for the adoption of (arguably) efficient market-based mechanisms to

produce better government spending and decision making. This type of transparent debate is therefore necessary, more now than ever, to determine the proper normative weight of efficiency claims within the democratic discourse.

Part I briefly surveys the law and relevant academic literature justifying charitable relief. It elaborates on the tax expenditure paradigm and explains why charitable relief should be perceived as a tax expenditure. Part II critiques the current literature. Part III examines the participatory value of charitable contributions and highlights its role in justifying charitable relief. It then develops the Article's dual analysis justification. Part IV extends the theoretical conclusions of the analysis to the actual problems charitable relief poses to policymakers. It offers a policy tool and uses it to analyze two contemporary and relevant case studies.

I. THE CHARITABLE DEDUCTION IN CONTEXT

This Part lays out the different theoretical justifications for charitable relief by examining the academic literature justifying the preferential tax treatment of charitable contributions. This Article does not limit its discussion to the charitable relief scheme in § 170 of the United States Internal Revenue Code (I.R.C. § 170),¹¹ but, nevertheless, refers to many aspects of this legislation. These references are necessary to substantiate the Article's argument by relating it to current legal practices. Therefore, even though there is no mystical truth in current I.R.C. § 170 conventions, it is important to first understand the way charitable relief operates under the United States' income tax regime.

A. The Legal Framework

Section 170 of the Internal Revenue Code allows individual and corporate taxpayers to deduct the fair market value of their charitable contributions from their income tax liabilities.¹² To deduct payments, taxpayers must meet a number of direct legislative and judicial requirements.¹³ First, contributions are deductible only if they are made to

11. I.R.C. § 170 (2006).

12. Section 170 states:

There shall be allowed as a deduction any charitable contribution payment of which is made within the taxable year . . . [T]he term "charitable contribution" means a contribution or gift to or for the use of . . . [a NPO] organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or . . . amateur sports competition . . . or for the prevention of cruelty to children or animals"

I.R.C. § 170(a)–(c); see also Daniel Halperin, *A Charitable Contribution of Appreciated Property and the Realization of Built-In Gains*, 56 TAX L. REV. 1, 1–2 (2002) (explaining how the deduction of the fair market value (FMV) of appreciated property results in a huge tax subsidy).

13. Johnny Rex Buckles, *When Charitable Gifts Soar Above Twin Towers: A Federal Income Tax Solution to the Problem of Publicly Solicited Surplus Donations Raised for a Designated Charitable Purpose*, 71 FORDHAM L. REV. 1827, 1849 (2003) (summarizing some of these limitations); M. Jill Lockwood & Leslie B. Fletcher, *An Array of Rules Govern Charitable Contributions*, 72 PRAC. TAX STRATEGIES 87, 87–88 (2004). Congress incorporated this common law doctrine into the tax code. I.R.C. § 170(f)(8).

tax-exempt organizations that meet certain criteria. According to I.R.C. § 170, these tax-exempt organizations must be exclusively engaged in promoting at least one of a set of predetermined purposes that include religious, charitable, scientific, literary, and educational purposes. The Internal Revenue Service (IRS) also has the authority to disallow tax-exempt status to organizations that undermine public policy.¹⁴ Second, deductions may not exceed fifty percent of an individual taxpayer's adjusted taxable income,¹⁵ and a corporation's contributions are limited to ten percent of its adjusted taxable income.¹⁶ Third, contributions should be nonconditional gifts made without return expectations.¹⁷ Finally, charitable contributions are available only to itemizing taxpayers¹⁸ and limited indirectly by general I.R.C. provisions that blunt taxpayers' ability to take deductions.¹⁹

Although contributions qualify for charitable relief only when made to tax-exempt NPOs, this Article distinguishes analytically between the NPOs' tax-exempt status and charitable relief granted to taxpayers making charitable contributions.²⁰ Even though the two are connected, the tax code does not grant taxpayers charitable relief when they contribute to certain unqualified tax-exempt organizations.²¹ One can also imagine situations where contributions made to for-profit firms that promote charitable objectives would be entitled to some type of tax subsidy similar to charitable relief.²² This Article separates these two issues and refers only to charitable relief and not to the exemption.

14. *Bob Jones Univ. v. United States*, 461 U.S. 574, 585–87 (1983); *see generally* Nicholas A. Mirsky, *Is It "Charitable" to Discriminate?: The Necessary Transformation of Section 501(C)(3) into the Gold Standard for Charities*, 2007 WIS. L. REV. 45.

15. This would become thirty percent when contributing to private foundations. I.R.C. § 170(b).

16. *Id.*

17. *See* Leonard Goodman & Jay A. Soled, *Tax Consequences Associated with Quid Pro Quo Charitable Contributions*, TAXES, Jan. 2004, at 59, 59; *cf.* *Comm'r v. Duberstein*, 363 U.S. 278, 284–90 (1960) (promulgating a subjective test for deductibility). The I.R.C. requires a charity to notify a donor whose contribution is in excess of seventy-five dollars of the good faith estimate of the FMV of the goods and apply the deduction only to the excess amount. I.R.C. § 6115(a) (2006).

18. These are taxpayers that prefer to itemize their different deductions rather than taking the standard deduction. *See* I.R.C. § 63 (2006). They are typically the more affluent taxpayers.

19. *See* Deborah M. Weiss, *Tax Incentives Without Inequity*, 41 UCLA L. REV. 1949, 1950–51 (1994). Examples of I.R.C. provisions that limit taxpayer's ability to make below-the-line itemized deductions are I.R.C. §§ 55, 67, 68 (2006) (the alternative minimum tax and the three percent reduction in all itemized deductions).

20. *See generally* Daniel Halperin, *Does Tax Exemption for Charitable Endowments Subsidize Excessive Accumulation?* (Working Paper, 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1143458 (explaining the nature of the tax exemption subsidy to charitable institutions).

21. *Cf.* I.R.C. § 501(c)(4) (2006) (defining tax-exempt "social welfare" organizations).

22. For example, people who are concerned about the environment and the need to reduce the amount of nonbiodegradable waste may want to contribute money to the research and development of for-profit firms that develop "green" diapers and recyclable plastic bags. *See generally* Anup Malani & Eric A. Posner, *The Case for For-Profit Charities*, 93 VA. L. REV. 2017 (2007).

B. The Tax Expenditure Paradigm: Is Charitable Relief Really a Government Subsidy?

Some commentators have justified the deductions under I.R.C. §170 as necessary to accurately measure taxpayers' income base.²³ According to this argument, contributions should be deductible because they reduce taxpayers' income and their ability to pay. This argument, and those that have followed it in recent years,²⁴ have been persuasively refuted as inconsistent with fundamental tax-policy principles.²⁵ It neglects the fundamental notion that income is attributed to the taxpayer that earns it and not to the persons to whom it is assigned. As with other types of not-necessarily-deductible payments, taxpayers exercise full control in directing their charitable contributions. This control allows taxpayers to tailor contributions according to their personal preferences.²⁶

In contrast, this Article uses the principles of the tax expenditure analysis as the baseline for discussion. In sharp contrast to the income-base justification, the tax expenditure justification for charitable relief relies on the discretionary nature of contributions. Because taxpayers are not obliged to contribute, incentives to encourage charitable contributions are justified—even if they deviate from fundamental tax base computation principles.²⁷ This characterization has support among academics and tax policymakers, who typically classify charitable deductions as tax expenditures.²⁸

The tax expenditure concept is part of a general debate about the role of tax incentives in the budgeting process and about how tax incentives should be designed. Broadly defined, tax expenditures are tax measures that deviate from the “classic” income tax policy objectives of measuring income properly and allocating the tax

23. See William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309, 309–17 (1972); Thomas D. Griffith, *Theories of Personal Deductions in the Income Tax*, 40 HASTINGS L.J. 343, 344–45 (1989) (summarizing Andrews's model).

24. See, e.g., Johnny Rex Buckles, *The Community Income Theory of the Charitable Contributions Deduction*, 80 IND. L.J. 947 (2005).

25. See Gergen, *supra* note 7, at 1414–26.

26. This raises the question of why personal preferences toward charity require special tax consideration. Without addressing this question, it is difficult to define what a charity is and to distinguish charitable contributions from other payments taxpayers make to meet their preferences. See *id.* at 1416, 1424. It is sufficient to conclude that charitable relief's income-base theory justification could be understood more narrowly as a claim that charitable contributions *should not* be considered as part of a taxpayer's tax base, which is different from the original claim that contributions *are not* part of the tax base. See Boris I. Bittker, *Charitable Contributions: Tax Deductions or Matching Grants?*, 28 TAX L. REV. 37, 37–39 (1972) (giving an income-base justification, which is much closer to this notion); John K. McNulty, *Public Policy and Private Charity: A Tax Policy Perspective*, 3 VA. TAX REV. 229, 242–43 (1984). For the above reasons, this Article *does not* treat the income-base theory as an independent justification for charitable relief.

27. See Todd Izzo, *A Full Spectrum of Light Rethinking the Charitable Contribution Deduction*, 141 U. PA. L. REV. 2371, 2381 (1993).

28. Charitable contributions are classified as tax expenditures by both the Joint Committee and the Treasury Department. See JOINT COMM. ON TAXATION, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2007–2011, at 2–3 (2007); OMB REPORT, *supra* note 1, at 257–59.

burden according to a distributive pattern determined through the tax rate.²⁹ Instead, they represent governmental interventions in the economy that aim to affect taxpayers' activities and the composition of their assets.³⁰ For example, if the federal government wants to promote home ownership, it can do so in at least two ways: the Treasury Department can directly transfer funds to individuals purchasing homes, or it can offer them tax relief. The revenue and distributional impacts of these two alternatives depend on their actual design, and, at least theoretically, they can be equivalent. The common denominator of all the various tax relief possibilities is that they modify taxpayers' liabilities in a way that is not related to their actual income. For example, under current income tax principles, buying a home is private consumption that does not relate to taxpayers' attempts to produce income. Thus, the mortgage interest deduction (tax relief) is considered a tax expenditure because it promotes home ownership and deviates from the general principles of how to measure income, which—even though not sacred—comprise the core of income tax policy.

Instead of using tax expenditures to promote government spending, some scholars—most notably Stanley Surrey—propose having a comprehensive income tax base with no tax expenditures. They argue that this would promote a more efficient and equitable governmental mechanism of revenue raising and spending.³¹ Surrey and others implicitly assume that tax expenditures are undesirably regressive and that government can achieve all its goals through direct spending.³² This assumption is by and large based on the U.S. experience, where many tax expenditures are granted in the form of personal deductions; these deductions only benefit upper-middle-class taxpayers that itemize their deductions rather than taking the standard deduction.³³

Although widely used, the concept of tax expenditures suffers from inherent vagueness because income tax theory has neither an agreed upon “correct” way of measuring income, nor a set of clearly stated distributional objectives.³⁴ This conceptual haziness has attracted a lot of criticism as to whether the notion of tax expenditure is at all useful. Over the years, the inefficiency and regressive assumptions have also been criticized on conceptual, factual, and political grounds.³⁵

29. See generally JOINT COMM. ON TAXATION, *supra* note 28, at 2–3; OMB REPORT, *supra* note 1, at 257–59.

30. See Levmore, *supra* note 8, at 387–88; Daniel N. Shaviro, *Rethinking Tax Expenditures and Fiscal Language*, 57 TAX L. REV. 187, 189–92 (2004).

31. See generally STANLEY S. SURREY, *PATHWAYS TO TAX REFORM: THE CONCEPT OF TAX EXPENDITURES* (1973) (discussing Surrey's trailblazing work on tax expenditure theory).

32. See *id.*; Shaviro, *supra* note 30, at 202.

33. One of the best examples for this is the home mortgage deduction. See I.R.C. § 163(h) (2006). This deduction benefits mostly the upper middle class. See JOINT COMM. ON TAXATION, *supra* note 28, at 43.

34. See Griffith, *supra* note 23, at 345–47; Shaviro, *supra* note 30, at 208–13 (analyzing this difficulty by providing a number of key examples).

35. See Shaviro, *supra* note 30 (demonstrating that what comprises a comprehensive income tax base is vague in many cases); Victor Thuronyi, *Tax Expenditures: A Reassessment*, 1988 DUKE L.J. 1155, 1156 (suggesting that tax expenditures should be perceived as subsidies rather than as direct spending); David A. Weisbach & Jacob Nussim, *The Integration of Tax and Spending Programs*, 113 YALE L.J. 955, 957–61 (2004) (suggesting that once a governmental program is created, there is no prima facie reason to avoid utilizing the tax system to achieve the spending objectives, and that, in certain cases, the tax system's arrangements may be better

In the charitable relief context, I only partially accept the conclusions of the tax expenditure literature. I argue that charitable relief should be seen as a state subsidy to philanthropic activities. Even though I agree that there is no such thing as a comprehensive income tax base, it is clear that charitable relief deviates from general income assignment rules and that this deviation should be seen as a state subsidy.³⁶ I do not endorse the presumption of tax expenditure theorists such as Surrey that using the tax system is wrong or inefficient; to the contrary, I point out that charitable relief has a unique political function within the democratic decision-making process that cannot be replicated by a direct government-spending program.

As controversial as both the tax expenditure concept and classification are, the dilemma over the proper form of the expenditure elicits even greater controversy. Tax expenditures in the form of deductions primarily target the behavior of deduction-itemizing (high-income) taxpayers. Given a progressive marginal tax rate structure, deductions are “worth more” to taxpayers subject to a higher marginal income tax rate.³⁷ Deductions are necessary in the income tax calculation because an accurate measurement of income requires allowing taxpayers to deduct expenses undertaken in the process of generating income. However, tax expenditures are not aimed at measuring income but at providing incentives for certain behaviors such as buying a home (instead of renting) or philanthropic contributions (instead of consumption or saving). Because tax authorities can use means other than deductions to change behavior, deductions seem to be an inappropriate measure to achieve that end unless there is a special reason to change the particular behavioral patterns of high-bracket taxpayers.³⁸ Accordingly, many tax scholars suggest that tax expenditures should be promoted through tax-relief mechanisms such as tax credits,³⁹ which affect low and

tailored to government objective); Edward A. Zelinsky, *Efficiency and Income Taxes: The Rehabilitation of Tax Incentives*, 64 TEX. L. REV. 973, 975–77 (1986).

36. It is important to see that even though this analysis offers a useful tax policy tool, it suffers from some major analytical difficulties. At its core, it is not clear that the tax forgiven is indeed public (rather than private) money. Because there is no absolute correctness in taxing income and because there is no well-defined comprehensive income tax base, the conceptual baseline of the tax expenditure theory seems fragile. I do not address this issue in depth, but the general response is that once a fiscal tax base (not necessarily income) has been chosen it is easy to determine whether there are clear deviations from it. As in the case of charitable relief, measuring such deviations is easy and, moreover, essential because it allows for a more transparent and accountable budgetary decision-making process. I thank David Enoch for bringing this point to my attention.

37. For example, let us assume that there are two taxpayers, A and B, that are subject to different marginal tax rates—fifteen percent and forty percent, respectively. Both taxpayers receive a \$100 bonus from their employers, which they decide to contribute to different charities. If A had not contributed his bonus, he would have been subject to a fifteen percent tax; thus by donating it, he “sacrificed” an after-tax eighty-five dollars that could have been used for savings or personal consumption. If B had not contributed her bonus, she would have been subject to a forty percent tax; thus by donating it, she only “sacrificed” an after-tax sixty dollars that could have been used for savings and personal consumption.

38. See Lily L. Batchelder, Fred T. Goldberg, Jr. & Peter R. Orzag, *Efficiency and Tax Incentives: The Case for Refundable Tax Credits*, 59 STAN. L. REV. 23, 24, 28 (2006).

39. See Levmore, *supra* note 8, at 417–18 (suggesting a hybrid credit and deduction tax relief for charitable contributions).

medium income taxpayers more than deductions, especially if they are refundable.⁴⁰ Credit expenditures also reach broader segments of society and therefore may promote desirable behavioral changes more effectively.⁴¹ Moreover, they distribute the benefits of responding to tax expenditures more progressively than deduction expenditures.⁴²

C. The Substance-Subsidy Justification

Most tax academics and policymakers view charitable relief as a subsidy intended to increase the allocation of funds towards socially desirable goods and services.⁴³ To satisfy valid tax administration concerns, charitable relief subsidizes these functions when performed by regulated NPOs.⁴⁴ As such, this approach is typically associated with the tax expenditure literature and is referred to as the “subsidy approach.” For example, consider an individual subject to the highest marginal federal tax rate of thirty-five percent. If she contributes \$100 to her local opera house (an NPO), she will, under current legislation, receive a deduction for this same amount from her taxable income. Because her marginal tax rate is thirty-five percent, the deduction will ultimately save her thirty-five dollars. Therefore, in practice, the taxpayer contributes only sixty-five dollars to the opera house, and the federal government subsidizes it by indirectly transferring to the opera house the thirty-five dollars that it would have gained had it not provided the taxpayer with the deduction.

The substance-subsidy justification relies on the economic theory of public goods to justify charitable relief. In its basic form, this theory suggests that the free market cannot efficiently supply these goods—for example, national security and clean air—because they are non-rivalrous and nonexcludable. Without government action, these goods would go underprovided because of individuals’ rational tendency to free ride. Rational individuals would therefore seek to establish institutions that would assure the

40. To benefit from credits and deduction in a given fiscal year, individuals have to pay taxes. However, unlike in the deduction example, *supra* note 37, refundable credits are returns of taxes paid. Accordingly, a \$100 credit would be worth \$100 to all taxpayers that paid at least \$100 in a given fiscal year regardless of their marginal tax rate. A refundable credit of \$100 would provide any taxpayers entitled to claim it with a \$100 benefit, regardless of whether they paid any income taxes.

41. See Batchelder et al., *supra* note 38, at 51–57.

42. See *id.*

43. See Colombo, *supra* note 3, at 661; Pozen, *supra* note 6, at 551–52.

44. Claiming charitable relief for charitable contribution requires showing some proof that money has been forwarded to promote a charitable objective without any consideration in return. This requires a cumbersome mechanism that validates the integrity of such a receipt. Rather than allowing all individuals and for-profit firms to qualify as eligible to validate charitable relief receipts, it makes sense to impose this high level of bureaucratic control only on tax-exempt NPOs. To qualify for the exemption, NPOs already need to meet the same bureaucratic requirements—there is no significant additional compliance and administrative cost associated with validating the integrity of their charitable relief receipts. The charitable relief is just one out of an array of tax subsidies that tax legislation grants to NPOs. See Brody, *supra* note 7, at 694–714, 726–34 (providing an illuminating taxonomy of different covert tax subsidies, such as tax exemptions on income earned through exempt functions and investment income, the ability to issue tax-exempt bonds, and covert subsidies—for example, benefiting from demand-side subsidies including the education tax credits).

provision of these public goods through obligatory common action. Similarly, NPOs typically provide a broader set of goods that could be defined as “quasi-public” goods, such as health, education, art, and redistribution aimed at reducing poverty. While these goods do have targeted beneficiaries, they have non-rivalrous and nonexcludable positive externalities that justify government intervention to assure their optimal provision.

By providing a government subsidy, donor-directed charitable relief increases taxpayers’ tendency to transfer funds toward charitable organizations. Through contributions, charitable organizations increase their supply and lower the prices of the public goods they provide. Charitable relief also mitigates the free-riding problem by reducing the price of contributions and encouraging more private giving to underprovided social goods.⁴⁵ Hence, the mainstream justification for granting the subsidy to contributions made toward charitable objectives focuses on the positive externalities and the need to mitigate the free-riding problem. This reasoning resonates with the public goods theory more generally.

Nevertheless, given the nature of the substance-subsidy argument, it can only be justified if it can be shown that donor-directed charitable relief actually promotes its pronounced charitable objectives. This can be demonstrated in two ways—by showing more spending or by showing better spending.

This Article examines the “more spending” argument first. Charitable relief makes charitable contributions cheaper for the donors and, as in almost all types of human conduct, once the price is reduced, the demand to participate increases. Therefore, since charitable relief reduces the price of contributing, it increases the overall amount of contributions. However, this increase in contributions is not sufficient to prove that charitable relief results in more funds allocated to promote charitable objectives. To prove that, advocates of charitable relief must demonstrate that it achieves treasury efficiency—meaning an increase in the overall private and public funds allocated toward charitable objectives as a result of charitable relief. This calculation should subtract from the increase in contributions that were made only due to charitable relief the revenues lost by the government because of it, which could have been spent by the government to promote the charitable objectives. The ultimate outcome thus depends on the complicated interrelationships among the price elasticity of contributing, the marginal and effective average tax rates, and the nature of charitable relief. For example, deduction charitable relief offers taxpayers at the highest marginal tax rates the highest level of subsidy for their contributions. Hence, the demand for the contribution can be expected to increase in correlation with the marginal tax rate. On the other hand, an increase in the average tax rate reduces taxpayers’ available income and, with it, the potential supply of contributions.⁴⁶ The inverse impact of the average and marginal tax rates significantly complicates the analysis of whether the deduction meets the standard of treasury efficiency.

45. See RICHARD POSNER, *ECONOMIC ANALYSIS OF LAW* 541 (5th ed. 1998); Buckles, *supra* note 10, at 1282; Alice Gresham Bullock, *Taxes, Social Policy and Philanthropy: The Untapped Potential of Middle- and Low-Income Generosity*, 6 CORNELL J.L. & PUB. POL’Y 325, 335 (1997); Colombo, *supra* note 3, at 696–701; Gergen, *supra* note 7, at 1389.

46. Richard P. Davies, *A Flat Tax Without Bumpy Philanthropy: Decreasing the Impact of a “Low, Single Rate” on Individual Charitable Contributions*, 70 S. CAL. L. REV. 1749, 1753 (1997).

The analysis exhibits further complications when it incorporates a realistic approach to calculating the price elasticity of contributions. This elasticity is not only likely to vary between different groups of taxpayers, but it is also likely to respond to government spending patterns. For example, let us assume a scenario in which a conservative government reduces (effective and marginal) tax rates and subsidizes these tax cuts by refraining from allocating resources to alleviate poverty. This lack of governmental spending may affect people's philanthropic price elasticity and preferences and induce them to contribute to antipoverty charity programs.⁴⁷

For many years, I.R.C. § 170 deduction charitable relief was thought to promote treasury efficiency.⁴⁸ However, the 1980s tax reforms produced a much more ambiguous picture.⁴⁹ Those reforms drastically reduced most taxpayers' marginal tax rates, creating an expectation that the increased price of contributing would reduce overall contributions significantly. This did not happen. With the small exception of taxpayers in the upper income bracket,⁵⁰ contributions maintained their overall level despite the reduction in taxpayers' marginal tax rates.

The ambiguity created by the above data has raised doubts as to whether charitable relief actually promotes treasury efficiency⁵¹ and has compelled substance-subsidy proponents to justify charitable relief in other ways, such as by showing that it generates better spending. Nevertheless, better spending—which can be narrowly construed as the ability to efficiently promote a set of charitable objectives—is an

47. For example, the United States' relatively high preference for philanthropic spending could partially be explained by the relatively low rates of effective tax in the United States and the relatively low social spending on health and welfare in comparison to other Western Organisation for Economic Co-operation and Development (OECD) countries. The low social spending creates the demand for charity and the low tax rates create the supply.

48. See Conrad Teitell, *Charitable Organizations and the New Tax Law*, TR. & EST., Dec. 1993, at 46, 46 (demonstrating that the industry still unequivocally believes that higher tax means significantly more donations).

49. See Gerald E. Auten, James M. Cilke & William C. Randolph, *The Effects of Tax Reform on Charitable Contributions*, 45 NAT'L TAX J. 267, 288–89 (1992); Joseph J. Cordes, *The Cost of Giving: How Do Changes in Tax Deductions Affect Charitable Contributions?*, EMERGING ISSUES IN PHILANTHROPY SEMINAR SERIES (Urban Inst. Ctr. on Nonprofits and Philanthropy & Harvard Univ. Hauser Ctr. for Nonprofit Orgs., Wash., D.C.), 2001, at 1–3, available at http://www.urban.org/UploadedPDF/philanthropy_2.pdf.

50. See Yong S. Choe & Jinook Jeong, *Charitable Contributions by Low and Middle Income Taxpayers: Further Evidence with a New Method*, 46 NAT'L TAX J. 33, 33 (1993); Davies, *supra* note 46, at 1754 (claiming that evidence from the 1980s makes it clear that the price effect outweighs the income effect for taxpayers in the upper income brackets); Pamela Greene & Robert McClelland, *Taxes and Charitable Giving*, 54 NAT'L TAX J. 433, 436–39 (2001) (suggesting that the very wealthy tend also to have different preferences from other taxpayers); Laura Tiehen, *Tax Policy and Charitable Contributions of Money*, 54 NAT'L TAX J. 707, 707–11, 717 (2001).

51. See, e.g., Kevin Stanton Barrett, Anya M. McGuirk & Richard Steinberg, *Further Evidence on the Dynamic Impact of Taxes on Charitable Giving*, 50 NAT'L TAX J. 321, 321–23 (1997); James R. Boatsman & Sanjay Gupta, *Taxes and Corporate Charity: Empirical Evidence from Microlevel Panel Data*, 49 NAT'L TAX J. 193, 209 (1996) (suggesting that corporate contributions are relatively inelastic).

amorphous benchmark. Generally, charitable relief could be seen as promoting three types of efficiencies: collecting, spending, and informational.⁵²

With regard to collecting efficiency, charitable relief reduces the taxpayer's average tax rate. Since taxes are coerced transactions, taxpayers tend to invest in practices to avoid tax, and tax authorities must counter by investing in tax enforcement and collection. Since contributions at least partially substitute for government spending, governments can save the costs and inefficiencies associated with tax collection if they encourage individuals to circumvent costly bureaucracy and allocate publicly subsidized contributions to NPOs directly and voluntarily.⁵³

Charitable relief may attain spending efficiency if NPOs' spending promotes charitable objectives more efficiently than government spending. Indeed, scholars generally regard NPO spending as more innovative, experimental, risk taking, and responsive than bureaucratically constrained government spending.⁵⁴ If these assumptions concerning NPOs' spending are true, charitable relief promotes an efficient transfer from the government to the tax-exempt sector.⁵⁵

Finally, charitable relief can promote informational efficiency—which I narrowly define as achieving the relevant agreed upon charitable objectives⁵⁶—if taxpayers have information superior to that of the governmental agency. Because the government enjoys no monopoly over relevant information, a diffuse body of taxpayers may indeed retain such superior information. Moreover, governments may err in recognizing different means by which public goods could be best provided. While it is difficult to determine when taxpayers have better information than governments, the claim for informational superiority on some issues seems relatively strong. For example, individuals probably have better access to information about how to best provide local public goods and/or with regard to issues that they care about. This informational superiority allows donors to monitor NPOs' activities to ensure their accountability and to prevent abuse. For example, government experts may know how to macroconstruct the national education system, but individuals may better know their community's specific educational needs. On other issues, such as national security, centralized government has greater expertise related to supplying some public goods. Hence,

52. I wish to thank Ian Ayres for pointing out to me the importance of this distinction.

53. See Zelinsky, *supra* note 35, at 977 (suggesting that, especially with regard to small business, there may be lower transaction costs when using the tax incentives to promote government policies instead of direct spending).

54. See, e.g., Schizer, *supra* note 7, at 27–28; Simon et al., *supra* note 3, at 274.

55. See Zelinsky, *supra* note 35, at 977 (suggesting that, especially with regard to small business, there may be lower transaction costs when using the tax incentives to promote government policies instead of direct spending).

56. This definition refrains from questioning what the proper charitable objectives are. For example, if tax legislation recognizes education as a valid charitable objective, the relevant provision will itemize different educational objectives, such as promoting the education of children from low-income families. The substance-subsidy claim for informational efficiency assumes taxpayers may know better than the government which local organizations and programs provide better education to low-income children. It does not assume that taxpayers know better than the government what *qualifies as education*. This latter claim differs fundamentally from the former one. It assumes individual donors have a secondary information superiority that allows them to identify public goods and to prioritize these goods better than government officials would.

charitable relief relies on the synergy between public and private information to promote better provision of public goods.

Because taxpayers are required to spend their own money to qualify for charitable relief, the free-rider problem is somewhat mitigated because it guarantees that individuals allocate public funds only to promote those charitable objectives for which they care enough to spend their own money.⁵⁷ Individuals may also be more motivated to contribute if they have the ability to supervise the use of their contributions and to promote the charitable activities for which the contributions were made.⁵⁸ This cooperative relationship between NPOs and donors could encourage better spending,⁵⁹ and some scholars have argued that it is one of the main benefits of charitable contributions.⁶⁰

D. Levmore's Voting with Dollars Justification

In a landmark article in 1998, Saul Levmore argued that I.R.C. § 170's deduction-based charitable relief allows taxpayers to "vote" on which NPOs deserve additional public funds.⁶¹ Through the process of contribution, taxpayers channel public funds by investing their own resources in NPOs that, in their opinion, warrant more funding. Charitable relief therefore replaces a centralized government decision-making process that depends on the majority's approval with a decentralized process. In this vein, Levmore suggests with some persuasiveness that contributions are important because they signal to policymakers which public goods are undersupplied and which NPOs warrant funding.⁶² However, Levmore's most fundamental innovation was his argument that charitable relief encourages taxpayers to supplement the government decision-making process in deciding what charitable objectives are indeed undersupplied and require more public spending. Although this argument points to the signaling and participatory effects of charitable contributions, Levmore does not provide a full account for how these participatory aspects interact with the substance-subsidy justification. Moreover, Levmore neither accounts for the role of charitable

57. See POSNER, *supra* note 45, at 541; Levmore, *supra* note 8, at 416.

58. See Levmore, *supra* note 8, at 406.

59. Schizer, *supra* note 7, at 56–57.

60. The notion that could be advocated here is that this type of cooperation between NPOs and donors makes the latter more extrospective, which may have positive externalities such as increased social solidarity.

61. See generally Levmore, *supra* note 8. Other scholars have accepted this reasoning. See, e.g., Staudt, *supra* note 9, at 572–73.

62. This argument is appealing but it requires additional explanations for why the voting process and other measurements (e.g., media) offer inadequate signals, and, more importantly, why this signaling process should be based primarily upon the donative preferences of wealthy taxpayers. Although Levmore does not endorse deductible charitable relief, he rejects the desirability of refundable credits and argues that only taxpaying individuals should enjoy charitable relief. Given the lower available income of less affluent taxpayers, any type of charitable relief, even if based on government matching, would exclude some less well off taxpayers. This implies that contribution signals are bound to be skewed toward the preferences of the upper classes. This attribute poses a serious "democratic" challenge that Levmore's analysis does not fully address.

relief as a nondemocratic allocation mechanism within a democratic regime, nor explains how it relates with principles of democratic governing.

Some writers have characterized this “supplementing” argument as promoting pluralism or communitarianism as secondary benefits.⁶³ This argument, however, wrongly marginalizes Levmore’s contribution. From a mainstream democratic perspective, pluralism is not necessarily a free-standing value that always contributes to the democratic decision-making process. Putting aside the intersection of democratic theory with issues of multiculturalism,⁶⁴ which this Article does not address, pluralism is a possible result of participation in the democratic process, but does not guarantee its integrity.⁶⁵

Viewed as an end result, pluralism could be seen as a public good or a positive externality of charitable relief. As an empirical matter, charitable relief’s enhancement of contributions may (or may not) result in pluralism depending on the identity and the preferences of donors. In most cases, charitable relief probably advances more diversified public spending because it allows minority and special interest groups to coordinate and assure the allocation of funds to promote their objectives.⁶⁶ However, this pluralist result may not always follow. For example, in certain circumstances contribution preferences of different people may converge in light of unusual events, such as national crises and natural disasters. Furthermore, like almost any type of tax expenditure (other than a refundable credit), charitable relief encourages contributions mainly among wealthy taxpaying individuals. This blunts charitable relief’s pluralist impact by suggesting that it encourages elite pluralism; thus, charitable relief falls far short of promoting a broader pluralist impact.⁶⁷ This leads to a larger question of whether tax expenditures (other than refundable credits) can advance underrepresented minority groups. It is possible that other more narrowly tailored policy tools (e.g., affirmative action) present more effective ways of reaching this goal.

II. THE SUBSTANCE-SUBSIDY JUSTIFICATION: CONCEPTUAL, FACTUAL, AND POLITICAL CHALLENGES

As explained earlier, the substance-subsidy justification promotes charitable relief as a way to provide more or better spending. It is essentially a consequential justification, which requires defining functions that are “socially desirable,”

63. See Buckles, *supra* note 10, at 1286, 1314; Wiedenbeck, *supra* note 4, at 96–97.

64. To be sure, some important theories of democratic decision making in a multicultural society may value diversity and pluralism. However, putting aside issues of multiculturalism, the participatory value of diversity and pluralism reduces significantly. In a monolithic society (e.g., many Scandinavian societies), the democratic process may function well even if society does not exhibit a great degree of pluralism and diversity.

65. It is not evident that pluralism is a public good at all. To be clear, I am not suggesting that pluralism is not a public good, but this is a separate question. Furthermore, I do not suggest that pluralism is undesirable, or that charitable relief does not generally promote it, but simply that the desirability of charitable relief’s participatory value is not conceptually connected to the desirability of pluralism.

66. See Izzo, *supra* note 27, at 2382.

67. This concern is acute with regard to I.R.C. § 170, because its charitable relief is available only to taxpayers who itemize their deductions.

determining whether charitable relief promotes these functions, and analyzing whether the costs outweigh the benefits of providing charitable relief. Simply put, to say charitable relief is justified because it promotes “good things” requires answering the following three questions: What does *good* mean? How are these good things promoted by charitable relief? Is this promotion good *enough* given its costs? As this Part demonstrates, the answers to these three questions are much less straightforward than what the “canonic” substance-subsidy approach may suggest.

A. What Does “Good” Mean?

The substance-subsidy justification requires tax policymakers to define the charitable objectives that merit charitable relief. This definition may rest on different justifications. One such justification relies on economic rationales associated with the difficulty of the private market to provide public goods. This line of reasoning is the core of the substance-subsidy justification. However, this reasoning does not suffice to define charitable objectives for two reasons. First, if the rationales supporting charitable relief are consequentialist, it is not clear why charitable relief should be restricted only to contributions and not to other transactions that promote charitable objectives. Second, the substance-subsidy justification presumes that more funding for charitable objectives is desirable, meaning that the majority’s tax-spending decision is insufficient and requires a charitable relief supplement. The supplementary nature of charitable relief cannot be derived from the assertion that NPOs promote undersupplied public goods. This assertion is consequentialist and, as such, simplistic because it does not account for why there is a need to supply more of these public goods in the first place. There are two other ways to define charitable objectives: popular conventions and legislative intent. However, these definitions fall short of providing policymakers with a rigorous analytical tool to judge whether innovative social practices qualify for charitable relief. This difficulty in defining the charitable objectives challenges one’s ability to justify charitable relief solely by the substance-subsidy justification.

In many cases, it is not clear that charitable relief should be restricted to contributions. Even though many public goods provide benefits to the entire society, there is always a group that gains more than others. As mentioned above, NPOs provide many quasi-public goods that can be rivalrously and exclusively consumed. Accordingly, rational taxpayers use charitable relief to promote and consume those activities that directly or indirectly privilege them. Because these “contributions” resemble private consumption, it is not clear how to distinguish between the two. Some consumption transactions (e.g., payment of museum fees) are related directly to NPOs’ charitable activities. Like charitable contributions, these payments provide NPOs with funds that help them provide more public goods associated with their exempt function. If contributions are not different from consumption transactions that promote charitable objectives, then one should not be denied charitable relief given to the other.

Nonprofit scholars—such as John Colombo—have dealt extensively with this issue. Colombo argues that tax authorities should deny charitable relief to transactions with specific price tags (e.g., sponsorships), which they currently recognize as

contributions.⁶⁸ According to Colombo, the benefits of these transactions are limited to a single consumer so that there is no free-riding problem or market failure that justifies charitable relief.⁶⁹ This argument provides a compelling value-free analysis that distinguishes between contributions and ordinary consumption. It seeks to counter forms of what could be considered abuse of charitable relief and to limit charitable relief's revenue impact.

This analysis, however, captures only part of the problem. Individuals purchase goods and services that promote public goods through private markets, even without a subsidy (e.g., museum tickets, education, and washable diapers). In these cases, the allowance of the subsidy shifts some of these private costs to the general public. Nevertheless, the substance-subsidy justification is met so long as the proceeds of a transaction support NPOs' endeavors to better provide undersupplied public goods. From the result-oriented standpoint of the substance-subsidy justification, if a market failure exists, the willingness of some people to purchase the product even without a subsidy becomes less important. The presumption that a market failure generally exists eclipses the potential absence of a failure as to some individuals.⁷⁰

Once the justification for charitable relief is anchored only upon promoting charitable objectives, the process by which NPOs raise money no longer matters. People both contribute and consume according to their own preferences, and the result-oriented substance-subsidy justification provides no analytical distinction between those preferences when both have a similar impact. Hence, without reference to contributions' normative content, it becomes impossible to distinguish them from other transfers of funds to NPOs. Therefore, although Colombo's argument cannot be

68. See Colombo, *supra* note 3, at 660, 696–701.

69. *Id.* at 698–99.

70. For example, let us assume that there is a society that deems art as an undersupplied public good and sets forth an objective to expose wider social circles to Renaissance masterpieces. Colombo argues that entrance fees to museums should not be granted charitable relief because people's willingness to pay the requested price suggests that there is no market failure that should be corrected by the subsidy. This of course is true only for the group of people willing to purchase exposure to Renaissance art at market price. It does not suggest anything about the broader social market failure that not enough people are exposed to Renaissance art. Put differently, the existence of a market price is not an indication that there is no market failure. If entrance fees, like contributions, were to merit charitable relief, tickets would effectively become cheaper and more people would come to see Renaissance masterpieces at museums. One should remember that charitable relief does not necessarily have to be deduction charitable relief, but can also be granted in the form of a refundable credit so that even low-income people could benefit from its subsidy. The same is true for sponsorships of museums. According to Colombo, sponsorships that have a quid pro quo price attached to them should not qualify as contributions because "donors" simply buy publicity and long-term advertisement. However, just like contributions, which do not have a price tag, charitable relief reduces the costs of sponsorships, thereby providing museums with more funds. These funds would allow museums to expand public exposure to the aesthetics of the Renaissance by reducing ticket prices, prolonging exhibitions, and purchasing more masterpieces. Accordingly, if museums cannot engage in price discrimination by providing charitable relief to entrance tickets and sponsorships, ordinary contributions may have the same impact on the way they perform their charitable function.

established on substance-subsidy grounds, it shows an important intuition—that transactions with price tags attached to them do not merit charitable relief.

The rationale of limiting charitable relief's revenue impact does not dictate a per se disqualification of quid pro quo transactions. Indeed, if charitable relief is granted to quid pro quo transactions, payments to NPOs would result in billions of dollars of revenue loss. It is nevertheless important to recognize that prohibiting quid pro quo transactions is not the only way to limit the revenue costs of charitable relief. The Treasury Department can deny charitable relief to major quid pro quo transactions between taxpayers and NPOs that provide services, such as education or health care, because they already benefit from a myriad of nonrelief tax expenditure subsidies.⁷¹ As a matter of tax policy, these specifically tailored tax expenditures, and not the broad, open-ended charitable relief, should govern the subsidy for these transactions.

Another major flaw in the substance-subsidy justification is that it assumes that there is a set of public goods that require more spending. According to this assumption, NPOs should help government provide these public goods. Charitable relief therefore provides NPOs with more income, allowing them to supply the goods at a level closer to the social optimum.

A weak critique of this assumption points out that NPOs may overprovide goods because of charitable relief. Since contributions are voluntary, volatile, and subject to loose government control, there may be cases in which some goods would be overprovided beyond the socially optimal level. Certain groups of taxpayers may prefer the over-provision of certain public goods and charitable relief may induce them to overinvest in the provision of those goods by imposing some of the costs of doing so on the general public. The intuitive appeal of this critique is most evident when charitable relief is designed to promote the preferences of a specific group of taxpayers (e.g., high-income, opera-loving taxpayers).

This "weak" critique implies a stronger normative blow to the substance-subsidy justification.⁷² Specifically, it suggests that *there is no such thing as one single "optimal level" in which different public goods should be supplied*. Rather, the "optimal level" is a political construct that depends on the objectives put forward by a relevant group of people engaged in a particular common-action enterprise. As a philosophical matter, there is a possibility that there may be extreme cases in which some allocation may clearly be inefficient. However, based upon group members' preferences and the group's decision-making mechanisms, a certain group may choose between an infinite number of legitimate, but difficult to compare, allocation decisions. It is futile to try and determine which of these decisions is correct and, by the same token, which of them is more efficient. What comprises an "optimal level" is, therefore, a matter of political legitimacy and not a positive inquiry about the efficiency of a specific allocation.

In modern society, the state is the most dominant common-action agent that regulates the provision of public goods. Therefore, the optimal provision of public goods depends on the diverse political decisions and priorities of each state. People have constructed different political arrangements to determine *their* optimal level. In a democratic society, governments are elected through a majoritarian process reflecting

71. See OMB REPORT, *supra* note 1, at 288–89.

72. I wish to thank Henry Hansmann for taking the time to discuss this issue with me.

the aggregated preferences of voters. Recurring elections offer voters the ability to correct government decisions. The government may not necessarily be the most efficient provider of certain public goods and may wish to outsource some of its functions. But the majority-elected government is the legitimate institution that makes the decision over what functions should be executed. Put differently, in a democracy, people invest in the determination of what comprises the “optimal” level of different public goods in the hands of representatives elected through a majority decision-making process. Given that the majoritarian process is the rule of the road, justifying the necessity of contributions on substance-subsidy grounds requires that its proponents prove that government supplies certain goods at a nonoptimal level. In a democratic society, proving this is difficult because there is no single allocation decision that is unquestionably *better* than the allocation decision reached by the majority.

Despite the delegation of decision-making power to representatives, there are democratic avenues available to citizens to criticize and change the majority’s decision. People may argue against a specific majority decision and, through deliberation and coalition building, may try to change it. However, granting individual taxpayers the authority to decide in place of the majority suggests a lack of faith in the majority decision-making process itself, rather than in any of its decisions. Therefore, the simplistic, substance-subsidy consequentialist definition of public good is not sufficient enough to justify charitable relief without first explaining the deficiency of a democratic process that grants elected representatives—not individual donors—the legitimate authority to determine the supply for different public goods.

Charitable relief is evidently a nondemocratic way of allocating public funds because it prefers individuals’ discretion over majority compromises. Its advocates face the challenge of explaining the normative grounds of incorporating such a nondemocratic allocation mechanism within the democratic regime’s framework. Furthermore, in most cases, charitable relief is actually *antidemocratic* (rather than “merely” *nondemocratic*). It typically distributes the right to allocate government spending in a nonegalitarian way, allowing only affluent taxpayers to use their contributions to allocate public funds. Unless charitable relief is designed as a refundable tax credit, people who do not pay income taxes cannot attain its benefits. Grounding the role of charitable relief within a democratic regime is therefore a difficult and unintuitive task.

To elaborate on this point, I.R.C. § 170 is designed as a below-the-line deduction.⁷³ Only taxpayers who itemize their deductions can benefit from charitable relief upon contributing. Moreover, because of progressive tax rates, I.R.C. § 170 provides the greatest subsidy to taxpayers at the high-income tax brackets.⁷⁴ Thus, in the United States, it is mainly affluent individuals who enjoy the tax benefits of charitable relief. This is arguably efficient, because it allows the government to use charitable relief to

73. Below-the-line deductions, also known as itemized deductions, are deductions that are not mentioned at I.R.C. § 62. Individual taxpayers who wish to itemize their deductions cannot take the standard deduction. *See supra* note 18.

74. *See McNulty, supra* note 26, at 252 (suggesting that much of the planning possibilities and many of the equity and efficiency objections to charitable relief are rooted in the progressive rate structure of the income tax).

target a behavioral change in high-income earners who have more available income.⁷⁵ Some may even claim that this arrangement is equitable if, as a result, rich people end up saving and consuming less for themselves and investing more in society.⁷⁶ From a democratic perspective, however, charitable relief constitutes a right to allocate public funds according to personal preferences. Under the U.S. tax regime, this right is distributed in a nonegalitarian, regressive manner and is effectively denied to the majority of individuals with low to medium incomes.⁷⁷ Charitable relief, therefore, helps to reinforce a political dynamic between two citizen classes by delegating to well-off donors an almost exclusive privileged-patrician status to allocate public funds. Regardless of its consequentialist outcomes, it is hard to see how the I.R.C. § 170 deduction could be incorporated in a society that venerates the democratic, majority-based decision-making process. One does not have to rely on the extreme case of I.R.C. § 170, however. In a democratic regime, where majority decision making constitutes the policy default, a shift to a nondemocratic mechanism, such as charitable relief, places the burden of proving that it does not infringe democratic values on the mechanism's proponents.

Skeptics may justly argue that there is no one "correct," "democratic" way of knowing what the polity wants.⁷⁸ Every majoritarian process has its own unique flaws, such as overweighting the preferences of lobby groups, voting paradoxes, and limited voice opportunities on certain issues. True as this objection may be, it does not shake the argument that charitable relief is nondemocratic by nature. Even though there is much disagreement on the details, the notion of the majoritarian one-person, one-vote process offers a relatively robust "baseline."⁷⁹ Justifying charitable relief requires a theory that explicitly explains why, in a democracy, the majority decision-making process should be supplemented and how charitable contributions can appropriately supplement it. The challenge therefore is to demonstrate that charitable relief is not antidemocratic, and that it can be reconciled with the democratic decision-making process despite its nondemocratic attributes. The analysis in the next Part of this Article will argue that this demonstration is possible, though not on substance-subsidy grounds.

75. *But see* Choe & Jeong, *supra* note 50, at 36–38.

76. *See* Halperin, *supra* note 12, at 8–9.

77. *See* Gergen, *supra* note 7, at 1406 (pointing out that charitable relief places the decision as to what goods should be funded "in the hands of those with wealth rather than those who vote"); Izzo, *supra* note 27, at 2374 (arguing that seventy-one percent of taxpayers, who are non-itemizers, do not have a voice in deciding how to allocate charitable relief's tax benefits).

78. I am thankful for Saul Levmore for forcefully making this argument to me.

79. As an intellectual matter, we do not need a pure Archimedean democratic point to see that charitable relief deviates from this principle, especially in those cases, such as I.R.C. § 170, where it bypasses majority approval and privileges only a specific affluent group of taxpayers. Conceptually, this is not different from a piece of voting rights legislation that would grant rich taxpayers more than one vote on certain tax-spending decisions. We do not need a pure democratic baseline to say that the multiple voting scenario is nondemocratic, and, by the same token, we do not need it to say charitable relief is nondemocratic as well. Nevertheless, it is important to note that despite its antidemocratic character, I.R.C. § 170 charitable relief does not detract from the overall democratic character of U.S. tax-spending budget decisions because the vast majority of public funds are allocated through the majoritarian process. *See infra* text accompanying note 125.

It is impossible to premise the substance-subsidy justification on a definition that equates charitable objectives with the notion of public goods. This, however, is not the only possible definition of charitable objectives. A second definition upon which the substance-subsidy justification can be premised is public policy. The public policy approach states that charitable objectives that should merit charitable relief are those typically considered worthy by the general public. This definition is value based and subjective.⁸⁰ Although the activities of most NPOs may easily qualify under this definition, it does not provide any analytic tools to determine which nonmainstream organizations should qualify for charitable relief.⁸¹

Finally, proponents of the substance-subsidy justification can argue that the charitable objectives meriting charitable relief are those that the legislature mentions as meriting it (the “plain legal meaning” approach). This definition is tautological; nevertheless, like many government spending programs, the legislative majority votes to single out objectives that require public spending. This definition offers the substance-subsidy justification a quicksand premise. As in the case of government spending, not every tax expenditure requires a special theory to justify it. However, charitable relief is different from other forms of direct spending and tax expenditures because it grants donors very wide discretion over how to spend their tax-subsidized contributions. In essence, charitable relief allows donors to determine what the proper public policy objectives are, how much should be spent on them, and how to best promote them.⁸² In contrast, direct spending programs channel restricted amounts to detailed purposes and tax expenditures typically impose specifically tailored requirements on taxpayers wishing to qualify for them.

In this context, the legal definition of charitable objectives is bound to be incomplete. Tax authorities and taxpayers require policy guidance as to what charitable objectives should be included in the literal language of the legislation. Majority approval fails to advance such guidance, in the same way that it fails to provide per se democratic legitimacy to legal rules. For example, I.R.C. § 170 provides that contributions to religious NPOs merit the deduction even though it is not entirely clear

80. See Gergen, *supra* note 7, at 1395–96; Mirkay, *supra* note 14, at 65–68.

81. See David A. Brennan, *Tax Expenditures, Social Justice, and Civil Rights: Expanding the Scope of Civil Rights Laws to Apply to Tax-Exempt Charities*, 2001 BYUL REV. 167, 189–91.

82. This is very different from just taking measures to qualify for benefits of programs approved by the majority. Consider, for example, the case of food stamps, which is a spending program that benefits only poor American families. Even though the government restricts the consumption to food, and sometimes only to specific products, it does not require recipients to go to government stores and buy menus designed by government experts. It therefore allows some decentralized decision making to efficiently promote the program’s goals of providing food security. There is, however, no comparison between the degrees of discretion granted by the government to recipients of the food stamps subsidy and to donors receiving the charitable relief subsidy. This is more than merely a matter of degree. As in many other cases, great differences in degree amount to substantive differences. For example, if a presidential candidate calls to tax only five percent of income she is a libertarian, but if she calls for taxing ninety-five percent she is a communist—drawing the line is still difficult but the distinction is clear. In the same way, the distinction between charitable relief and other types of tax expenditure and direct spending subsidies (which grant their recipients very limited discretion) is valid even if drawing the line is difficult. I thank Edward Zelinsky for encouraging me to elaborate on this issue.

that religious services could qualify as public goods.⁸³ It is therefore futile to dispute the validity of charitable relief given the explicit wording of the legislation. Without a theory, however, it is hard to establish what comprises religious activities.⁸⁴

Both the “public policy” and the “plain legal meaning” approaches intentionally equivocate over the precise meaning of charitable-relief-worthy objectives. Accordingly, neither approach helps to reconcile charitable relief with fundamental democratic decision-making principles. It is clear that none of the substance-subsidy approaches fully accounts for what “good” means, and that none of them offers a satisfying foundation for charitable relief’s substance-subsidy justification. Nevertheless, the public good definition of charitable objectives is the more theoretically sound base upon which such a justification could be grounded.

B. How Does Charitable Relief Promote “Good”?

As elaborated above, the primary weakness of the existing substance-subsidy literature is its failure to justify the democratic implications of charitable relief. Nevertheless, some may believe that there is no serious democratic flaw when an elected assembly delegates some allocation responsibilities over public funds to individuals who are better positioned to make these decisions. This Subpart addresses this critique by showing that the notion that individuals have the competence to make “good” allocation decisions through charitable relief is not as self-evident as the current literature assumes. Even if the socially desirable functions that justify charitable relief could be defined coherently, justifying charitable relief requires showing that it results in *more or better* spending on charitable objectives. Part I.B explained why it is questionable that charitable relief actually results in more spending. Here, I demonstrate that better spending is far from being a guaranteed outcome.

The notion that philanthropy attains better spending feeds, in part, on animosity toward government spending. Thus, while the conviction that charitable relief results in more spending seems to have been shaken by evidence from the 1980’s tax reforms, the “better spending” agenda has entrenched its position among academics⁸⁵ and politicians.⁸⁶ Moreover, the political *agenda* against big governments may explain the uncritical myopia about the shortcomings of the substance-subsidy better-spending justification. This almost per se conviction that charitable relief promotes collection, spending, and informational efficiencies is nevertheless invalid and highly disputable in many cases.

Tax collection is costly, although from a macrosocial perspective, it is probably less costly than fundraising.⁸⁷ Unlike mandatory tax rules, fundraising requires NPOs to

83. For a more in-depth discussion, see generally Lars G. Gustafsson, *The Definition of “Charitable” for Federal Income Tax Purposes: Defrocking the Old and Suggesting Some New Fundamental Assumptions*, 33 HOUS. L. REV. 587 (1996), arguing that Congress needs to adopt a narrower definition for “charitable” under the tax code instead of relying on the broad definition given by the judicial and administrative branches.

84. This subject will be explored in greater detail in Part IV.

85. See Schizer, *supra* note 7, at 9.

86. See DAVID WAGNER, WHAT’S LOVE GOT TO DO WITH IT? 1–2 (2000).

87. Data on the actual costs of fundraising are scarce. However, some indicators suggest that it is much greater than the costs of taxation. See Pozen, *supra* note 6, at 557–58.

identify and convince potential donors to contribute. NPOs' dependency on this erratic source of funding requires them to devote considerable resources to develop "marketing" expertise and ensure an ongoing flow of contributions necessary to develop long-term programs for providing public goods. This diversion of resources from promoting charitable objectives to fundraising distorts the functions of NPOs and their ability to effectively promote charitable objectives. It also hinders NPOs' ability to attract the skilled employees necessary to best promote their exempt functions since they must inevitably employ fundraisers. From an institutional perspective, the ongoing need for contributions elevates the status of fundraisers within NPOs. This is not a good outcome because fundraisers' expertise lies in raising money and not necessarily in promoting NPOs' charitable objectives. Most importantly, however, because contributions are voluntary and may fluctuate because of unpredictable events,⁸⁸ NPOs cannot make ambitious long-term plans that are often necessary for optimally providing public goods. Long-term investments may not have the short-term visibility necessary for fundraising. Hence, NPOs' collecting inefficiencies reduce their overall operational efficiency.

Even if NPOs achieve spending efficiency, this does not mandate the desirability of charitable relief. NPOs can be, and indeed in many cases are, agents to which the government outsources the provision of certain public goods. Thus, to the extent that NPOs achieve spending efficiency, there is good reason for government to outsource functions to them and to pay for this outsourcing with the tax money it collects. However, given NPOs' collecting inefficiencies, the fact that they may be efficient spenders does not explain why contributions made to them by individuals should merit charitable relief.

The notion that NPOs achieve spending efficiency, however, is not self-evident. NPOs' relatively low bureaucratic constraints allow them to operate more innovatively and efficiently than the government, but they do not guarantee an efficient outcome. Government bureaucracy is a cumbersome safeguard designed over the years to prevent major catastrophic misuse of public funds. Although far from perfect, the government employs mechanisms that tend to ensure an accountable and transparent use of public funds. NPOs' lack of bureaucratic constraints may result in less transparency of their spending decision-making process, leading to nepotism, nonprofessionalism, and waste. Moreover, to ensure efficient spending, the government should prevent influential donors from abusing charitable organizations as a favorable tax avenue to attain their own personal (not necessarily charitable) objectives. This monitoring of the donor-organization relationship is costly and only remotely effective given the NPOs' dependency on large donors.

Even if all NPOs were operating properly, some types of public goods require strong centralized government action. For instance, in the United States, many poverty relief functions are performed by NPOs. However, the operation of these organizations

88. Some events are more likely to compel contributions. For example, it was reported that the tsunami that hit the shores of Southeast Asia in the summer of 2004 had a huge impact on Africa because it diverted donations from the West toward Asian disaster relief. Additionally, contributions may depend on the changing preferences of the donors. For example, corporate donors engaged more in charitable giving after the Enron crisis when corporate America received bad publicity. Charitable giving was perceived as a way "to burnish their image[]." Linda Sugin, *Encouraging Corporate Charity*, 26 VA. TAX REV. 125, 126 (2006).

falls short of filling the vacuum left by a weak government in the event of a huge crisis, such as Hurricane Katrina.⁸⁹ Dealing with the poverty effects of Hurricane Katrina required huge-scale government intervention and planning. Even though the government provided a myriad of tax incentives to increase private giving directed at disaster relief,⁹⁰ this challenge was beyond the scope of even the combined efforts of all the large and well-established NPOs.⁹¹ Additionally, whenever policymakers set a comprehensive policy objective, coordinated government action may provide more efficient spending than NPOs, who do not necessarily coordinate their actions. Accordingly, targets such as hunger relief or vaccinations could be more efficiently enhanced by governments than by NPOs.⁹²

Finally, donors may indeed know better than government officials how to efficiently provide certain, mostly local, public goods. Yet, most donors probably have inferior knowledge about how to best provide and prioritize the provision of many other public goods.⁹³ For example, through their contributions, donors may provide beneficial information about how to best allocate public funds to promote public health in their own locality. In sharp contrast, effectively promoting national and international public health requires careful budgeting based on a long-term cost-benefit analysis. Most donors lack the ability to engage in such an analysis, which forces them to rely on alternative incomprehensive information sources such as media releases and independent experts, which are typically skewed by interest groups. For example, a fundraising campaign to fight HIV in Africa—a disease most Westerners are aware of—may raise more money than campaigns to reduce widespread diseases such as malaria, tuberculosis, and dysentery, which require much cheaper medication.⁹⁴ Large

89. As part of charitable relief, the IRS provided six general charitable incentives or rewards, including the temporary lifting of deduction limitations. See Patrick E. Tolan, Jr., *The Flurry of Tax Law Changes Following the 2005 Hurricanes: A Strategy for More Predictable and Equitable Tax Treatment of Victims*, 72 BROOK. L. REV. 799, 827 (2007). Moreover, donors were encouraged to donate books to public schools and food inventory. *Id.* It is not clear that lifting limitations on charitable relief resulted in more donations to hurricane victims—the average charitable giving per household remained the same in 2005 as in previous years, and only three percent of the charitable donations ended up targeting disaster relief. *Id.* at 839.

90. See Christine L. Agnew, *Recent Developments & Observations: Disaster Tax Relief*, J. PASSTHROUGH ENTITIES, Nov.–Dec. 2005, at 23, 24; Philip J. Harmelink & William M. Vandenburg, *Hurricane Tax Relief Provisions Have Nationwide Implications*, 76 PRAC. TAX STRATEGIES 96, 99–102 (2006).

91. True, NPOs may operate better than governments of failing states in dealing with large-scale crises. However, the low standard of living in these states and the inability of NPOs to improve those standards proves the indispensability of a strong government infrastructure.

92. Cohen, *supra* note 5, at 483–85.

93. Davies, *supra* note 46, at 1801.

94. Consistent with Joseph Stalin's horrific insight that "A single death is a tragedy; a million deaths is a statistic," Richard A. Posner, *The Economics of Capital Punishment*, in THE ECONOMISTS' VOICE: TOP ECONOMISTS TAKE ON TODAY'S PROBLEMS 237, 239 (Joseph E. Stiglitz, Aaron S. Edin & J. Bradford DeLong eds., 2008), there is evidence that suggests people donate more to far away causes if the issue is portrayed to them as an individualized story rather than as plain facts—even if these facts are very disturbing. This framing issue further brings into question the ability of individual donors to attain informational efficiency. Nevertheless, government officials may suffer from similar framing biases.

NPOs, such as the Gates Foundation and the United Way, may overcome some of these problems by employing an economy of scope and scale in obtaining and analyzing relevant information.⁹⁵ However, most charitable contributions are not channeled through large NPOs, and it is, at the very best, unclear whether all donors can add important information to government experts on other issues of public health. To establish informational efficiency, policymakers should restrict charitable relief to those instances in which there is solid evidence that taxpayers' grassroots information adds value to the information of governmental agents. In the United States and elsewhere, the scope of charitable relief extends to a wide variety of public goods and is not restricted to those primarily local public goods in which taxpayers may obtain better information than government officials.

In conclusion, the main pillar of the substance-subsidy justification is that charitable relief promotes more or better spending. However, this assumption is highly contestable. It is clear that charitable relief does not provide collecting efficiency, and in certain cases, it also does not provide informational efficiency. Whether it provides treasury or spending efficiency is also murky and questionable.

C. Is Charitable Relief "Good Enough"?

Assuming that charitable relief adheres to well-defined charitable objectives and that it encourages either more or better spending,⁹⁶ proponents of the substance-subsidy justification would still have to demonstrate that the direct benefits of charitable relief outweigh its negative externalities. State-subsidized charitable contribution is not a free good, but a social practice that generates various types of negative externalities. All types of externalities originate from the fact that taxpayers decide voluntarily, and according to their own personal preferences, how much and to which NPOs to contribute.

The first negative externality relates to the tax inequity generated from revenue loss. Like any other tax expenditure, taxpayers that receive benefits from charitable relief assign the revenue costs to other taxpayers. The Treasury Department needs to tax other taxpayers at a higher effective tax rate to recoup these revenues. If nondonors undervalue public goods provided through charitable contributions, charitable relief renders them worse off and infringes upon well-established notions of tax equity that prevent taxpayers from assigning their income.⁹⁷ By allowing donors to assign income to NPOs, charitable relief violates horizontal equity principles that require taxpayers to bear their tax burden according to their ability to pay the tax.⁹⁸

95. Gates Found., Our Approach to Giving, <http://www.gatesfoundation.org/about/Pages/our-approach-to-giving.aspx> (explaining how much the foundation invests to get information that will help it to evaluate its projects).

96. *But see* discussion *supra* Part I.C.

97. *See* Buckles, *supra* note 24, at 952.

98. Horizontal equity principles require that individuals with the same income pay the same amount of taxes. Charitable relief allows the reduction of overall taxes. Assume that there are two individuals with the same before-tax income. The first individual prefers going to church while the second one prefers joining cycling clubs. The first will pay fewer taxes because her contribution to the church (which in many respects resembles a membership fee) would be deductible, whereas cycling club memberships are not. As I argued in Part I, the spending

The second negative externality relates intimately to charitable relief's design. In many cases, including I.R.C. § 170, charitable relief is designed to induce philanthropic spending by high-income taxpayers. Since rich taxpayers may exhibit different philanthropic preferences than other social groups,⁹⁹ charitable relief ends up skewing public funds to support elite institutions that primarily serve the upper classes.¹⁰⁰ Indeed, evidence suggests that individuals with high incomes direct a higher proportion of their contributions toward NPOs that promote art and academic education.¹⁰¹ Nevertheless, an argument can be made that when rich taxpayers sponsor elite institutions, the government may be able to direct more resources toward the provision of other public goods. This scenario strikes me as implausible, however. As discussed earlier, it is far from clear that charitable relief generates treasury efficiency.¹⁰² Given the possibility that charitable relief results in less, rather than more, public spending, one would have to explain why governments would be more responsive to nonelite spending preferences. This requires a positive political theory that explains why charitable relief would impact low-income citizens' abilities to pressure the government to accept their spending preferences.¹⁰³

A third negative externality arises from donors' ability to receive charitable relief-related tax benefits while channeling contributions that increase their economic and political influence. This may include incidents where donors retain de facto discretion over the future allocation of their funds and contributions aimed at increasing their political power. This de facto control raises concerns because tax authorities cannot observe all the considerations underlying the agreements between donors and NPOs. Tax authorities may not spot many conduit transactions or other innovative

preferences of the individual who prefers going to church are not related to the measurement of her income; therefore, charitable relief infringes upon the principle of horizontal equity.

99. See Gerald E. Auten, Charles T. Clotfelter & Richard L. Schmalbeck, *Taxes and Philanthropy Among the Wealthy*, in DOES ATLAS SHRUG? THE ECONOMIC CONSEQUENCES OF TAXING THE RICH 392, 405 (Joel Slemrod ed., 2000) (suggesting that the rich tend to donate more to higher education and cultural institutions than other social groups); Greene & McClelland, *supra* note 50, at 436–39.

100. See Buckles, *supra* note 24, at 948–50 (suggesting that there is no compelling reason to believe that society is better off by subsidizing fine arts that satisfy elite preferences than by supporting NPOs that provide basic human services); Choe & Jeong, *supra* note 50, at 36–38; Halperin, *supra* note 12, at 9; McNulty, *supra* note 26, at 248.

101. See Wendy C. Hamblet, *The Geography of Goodness: Proximity's Dilemma and the Difficulties of Moral Response to the Distant Sufferer*, 86 *MONIST* 355, 363 (2003) (The inability to respond to the suffering of the poor is not “‘because of an evil heart’ but, rather, is more of an aesthetic aversion. If only beggars might show up in ‘silken rags and tattered lace and beg for alms dancing gleefully’ as they do on the stage and in the ballet . . . they might be able to make an appeal to our consciences.” (quoting FYODOR DOSTOEVSKY, *THE BROTHERS KARAMAZOV* 220 (Constance Garnett trans., Barnes & Noble Books 2004) (1880))); McNulty, *supra* note 26, at 248.

102. As discussed in Part II.B, to attain treasury efficiency, the sum of the contributions minus the taxes forfeited as a result of charitable relief should be greater than the overall amount of contributions that would have been made absent charitable relief.

103. In my opinion, this type of theory is hard to sustain given the substantial evidence suggesting that the interests of low-income groups are underrepresented in the legislative and spending processes. In the United States, charitable relief itself is the best example of the small impact that low-income groups have had on legislative and budgetary processes.

contribution tax-planning schemes.¹⁰⁴ Thus, apart from its designated charitable objectives, charitable relief may indirectly subsidize NPOs' political involvement. This influence is most tangible in those NPOs that generate excessive dynastic wealth.¹⁰⁵

In the United States, the charitable relief scheme incorporates many mechanisms intended to limit the potential negative externalities of contributions on the political process. For example, the I.R.C. directly and indirectly caps the percentage of a donor's annual income that qualifies for a deduction;¹⁰⁶ common law regulates the deductibility of earmarked donations;¹⁰⁷ and courts allow the IRS to deny charitable relief for contributions constructed as quid pro quo transactions or made to NPOs that are dissonant with general public policy. Tax law also heavily regulates NPOs that allow donors to maintain high degrees of control over their contributions,¹⁰⁸ restricts NPOs from engaging in partisan political activity, and limits their ability to engage in lobbying.¹⁰⁹ However, given the IRS's limited enforcement capability, these restrictions flounder when donors strive for control and political influence along with NPOs and political candidates' demands for funding.¹¹⁰

104. Conduit transactions are transactions in which money is transferred to certain entities, in this case NPOs, only for the purpose of then being transferred to a different person. The transfer to the NPO is necessary to attain tax advantages and to comply with regulatory obligation, but it is not the true purpose of the transfer. See Buckles *supra* note 10, at 1315 (arguing that, in reality, large donors exercise a very prominent voice in the operations of NPOs); John McGown, Jr., *Major Charitable Gifts—How Much Control Can Donors Keep and Charities Give Up?*, 91 J. TAX'N 279, 286 (1999).

105. See Lee A. Sheppard, *Hedge Funds' Favorite Charity*, 116 TAX NOTES 224, 224–26 (2007) (discussing the accumulation of wealth in different charities and the claim that this accumulation contradicts the purpose of supporting NPOs that are created exclusively to promote charitable objectives). See generally, John G. Simon, *Charity and Dynasty Under the Federal Tax System*, 5 PROB. LAW. 1 (1978) (discussing the threat of dynastic charitable foundations).

106. See Brody, *supra* note 7, at 699; C. Eugene Steuerle & Martin A. Sullivan, *Toward More Simple and Effective Giving: Reforming the Tax Rules for Charitable Contributions and Charitable Organizations*, 12 AM. J. TAX POL'Y 399, 408 (1995) (discussing the limitation restricting individuals' contributions to public or private charities—donations to public charities may not exceed fifty percent of adjusted gross income, while donations given to private charities may not exceed thirty percent of adjusted gross income); Weiss, *supra* note 19, at 1950–51 (explaining how tax incentives are restricted by the alternative minimum tax, which is described as a “corrective tax”).

107. See Buckles, *supra* note 10, at 1264–68 (explaining the factors determining the deductibility of earmarked contributions and arguing that the law in this area lacks clarity).

108. Tanya D. Marsh, *A Dubious Distinction: Rethinking Tax Treatment of Private Foundations and Public Charities*, 22 VA. TAX REV. 137, 148–60 (2002) (summarizing the key distinction between private and public charities and discussing the assumption that private charities are more likely to be controlled by wealthy donors, thereby making private charities disfavored under the I.R.C.).

109. See I.R.C. § 501(c)(3), (h) (2006).

110. See Marsh, *supra* note 108, at 139 (arguing that the distinction between private and public charities serving as a proxy for donors' control over their contributions has blurred in the last twenty-five years to the extent that there seems to be little justification to support it); David Wheeler Newman & Jose Silva, *A Look at Alternatives to Private Foundations*, TR. & EST., Aug. 1994, at 10, 16–19 (explaining how private foundation restrictions could be bypassed by

A fourth negative externality arises from the fact that charitable relief, as any other tax expenditure, renders tax legislation more complicated and opaque. Consequently, it offers fertile grounds for tax loopholes to develop far away from the public eye. For example, I.R.C. § 170 provides well-advised taxpayers with a significant tax break when they donate appreciated capital assets and certain types of inventories.¹¹¹

Altogether, these four types of negative externalities may undermine public opinion about the integrity of the income tax.¹¹²

D. The Substance-Subsidy Justification: Some Final Remarks

*“[Substance-]subsidy theories ultimately justify the [relief] on the grounds that, on balance, it benefits society.”*¹¹³

The claim that charitable relief could be justified solely on substance-subsidy grounds is questionable. As demonstrated above, benefits derived from charitable relief are not as self evident as many tend to think. Charitable relief does not necessarily promote more or better spending on charitable objectives and creates serious negative externalities. However, the lack of a complete and coherent definition of charitable objectives is the most serious obstacle that the substance-subsidy approach must overcome. Without an explanation for how contributions supplement the democratic majoritarian decision-making process, it is not clear that the public goods contributions help provide, or indeed require, more public spending.

This deficiency is rooted in every aspect of the substance-subsidy justification for charitable relief. Like any other result-oriented justification, the substance-subsidy justification requires promulgating a set of clear, desirable results for policymakers to judge whether the means for attaining them are suitable. The objectives are therefore external to the substance-subsidy justification and cannot be provided from its result-oriented logic. A result-oriented justification can explain how to best achieve certain objectives, but cannot, by itself, justify those objectives.

III. THE MISSING LINK: THE PROCESS-SUBSIDY JUSTIFICATION

The best justification for charitable relief hinges upon its nonmajoritarian attributes, which actually help to refine the outcomes of the democratic decision-making process.

directing funds to support organizations); Gerald B. Treacy, Jr., *Alternative Corporate Giving Formats*, 43 Tax Mgmt. Memo. (BNA) 387, 393–95 (Sept. 23, 2002) (explaining how corporations could attain maximum tax benefits while retaining maximum control over the money they spend, typically through the use of support organizations).

111. See Nicholas C. Tomlinson, *Tax Abuse Halting Progress? An Inside Look at Patent Donations and Their Tax Deductibility*, 35 Sw. U. L. REV. 183, 192 (2006).

112. For example, as mentioned above, taxpayers cannot attain charitable relief for portions of charitable contributions that exceed a certain percentage of their adjusted gross income. Congress introduced these limitations in 1969. The legislative history of this amendment suggests that Congress was motivated to limit the ability of high-income taxpayers to claim charitable relief because it was afraid that unlimited deductibility for charitable contributions eroded the public’s confidence in the fairness of the income tax system. Fleischer, *supra* note 3, at 202–03.

113. Buckles, *supra* note 24, at 954.

The majoritarian taxing-spending decision involves inherent structural limitations, which prevent certain preferences from being voiced and addressed. Therefore, tax-subsidized philanthropy should be understood not only as a method of determining what public goods are undersupplied, but also as a way to respond to unheard and unaddressed preferences; this may be referred to as the process-subsidy justification. Even though charitable relief is nondemocratic in its very essence, it can operate to be compatible with the democratic framework. In other words, although the democratic regime relies on majority voting as a means to meet certain vital ends,¹¹⁴ some limited deviations from it can be made to promote other competing goals such as promoting a more viable allocation of public funds. Charitable relief can correct some of the imperfections associated with democratic decision making in a way that does not undermine the centrality of the majority's decision. As such, the tax-subsidized contribution process offers an important supplementary option.

To serve as a supplement, however, charitable relief needs to meet certain requirements, including substance-subsidy requirements, which limit it only to contributions that promote a set of predetermined, broadly defined public goods. The end result is interesting. Charitable relief is justified because it results in "good things" and, more importantly, because contributing is in certain cases a "good way" for supplementing the democratic process.¹¹⁵ Charitable relief should thus be granted only when a contribution triggers these two results. The key insight of this synthesized approach is that charitable relief's justification depends on how it fits within the broader democratic framework and not upon the public-good attributes of charitable objectives.

Indeed, Levmore's "voting with dollars" explanation highlights that charitable relief provides a dynamic avenue for taxpayers to signal their preferences to the government and to help it decide what the proper allocation of public funds should be. Levmore suggests that when taxpayers contribute to NPOs, they engage in a process that determines both the size of the public budget and its allocation.¹¹⁶ The analysis in Part II also establishes the following two relevant notions: (1) that charitable relief allows an allocation that effectively bypasses the democratic norm that public money should be allocated through a political process of majority vote and coalition building, and (2) that the loss of revenues due to charitable relief challenges the role of the majoritarian decision-making process because it requires the majority to amend its tax-spending decisions.

Despite the above notions, this Article argues that charitable relief can be structured so as to remedy the allocation costs of the democratic process in a way that does not defy core principals of democratic theory. Charitable relief reflects a legislative understanding that the majority decision-making process of allocating public funds is virtuous but incomplete.¹¹⁷ This incompleteness is most evident when voters'

114. One such example is to safeguard against tyranny.

115. Rather than arguing that contributing has a pure deontological value, I argue that charitable relief serves the value of efficiently allocating public support toward different public goods. However, there is a deontological element in this process justification because charitable relief is not only a way to achieve efficient allocation, but also a mechanism that indicates what the efficient allocation is.

116. See Levmore, *supra* note 8, at 406–07.

117. See *id.* at 427.

preferences are heterogeneous. Due to the lack of perfect information in a representative democracy,¹¹⁸ voters choose candidates most likely to best promote their top-priority preferences.¹¹⁹ In this scenario, many types of preferences would not be part of the election agenda, even though they may be highly valued by a significant number of people. Thus, representative democracy's majority decision-making process undervalues many of the populace's spending preferences.¹²⁰

The democratic process can yield unsatisfying allocation results even in a democracy where all issues are taken into account by policymakers. In a society where preferences over the desirability of public goods vary considerably, many small groups would not be able to form coalitions that would result in spending on those public goods they value. For example, let us assume that there is a state with 500 million individuals in which everybody agrees that there are 502 possible public goods that could be funded by the government. However, through the particularly cumbersome democratic process, this state is only able to achieve a stable spending coalition with regard to two public goods: education and security. Let us also assume that there are 500 groups in the state, comprised of approximately one million people each. Every group has a strong preference that (a different) one of the other 500 listed public goods is supplied. Accordingly, if a charitable relief-like mechanism is not instituted to supplement the majoritarian taxing-spending decision-making process, the democratic process results in a very crude allocation. Each of the 500 million citizens is frustrated because neither the market nor the government is able to efficiently supply their individually preferred public goods. In this type of society, it is easy to see why many individuals may be supportive of a limited charitable relief-like mechanism that makes coalition building easier for each of them to support the public good they most deeply care about.

This analysis should not be surprising. Democracy is a process of ruling through compromise so that even a "perfect" democratic process is bound to result in some dissatisfaction. The above example does not suggest that these high costs render the democratic, majoritarian decision-making process undesirable. Rather, it suggests that

118. See Schizer, *supra* note 7, at 9.

119. See Fleischer, *supra* note 3, at 185–86; Burton A. Weisbrod, *Toward a Theory of the Voluntary Nonprofit Sector in a Three-Sector Economy*, reprinted in *THE ECONOMICS OF NONPROFIT INSTITUTIONS* 21, 37–40 (Susan Rose-Ackerman ed., 1986).

120. In a way, the issue of charitable relief resembles the issue of civil disobedience. In the case of civil disobedience, dissenters follow their own discretion (or, in my opinion, moral preferences) without obtaining the majority's approval. Like charitable relief, this decision requires the majority to adjust its policy. Therefore, if a country decides to go to war and a group of people objects to the war and refuses to enlist, that country would either have to change its plans or recruit other people. In the same manner, contributing donors gain the ability to allocate public funds in a way that requires the majority to either reduce its spending decisions or to raise taxes. People who justify civil disobedience typically regard it as an important, nondemocratic safeguard to democracy that forces the majority to reconsider its position. This comparison draws some interesting parallels between charitable relief and civil disobedience with regard to how different nondemocratic elements can provide important supplements to the democratic process. See generally Daniel Markovits, *Democratic Disobedience*, 114 *YALE L.J.* 1897 (2005) (discussing how democratic disobedience can be a justified protection to democracy). I wish to thank Avihay Dorfman for bringing this point to my attention.

in some cases these costs are *unduly* high because reaching decisions through a democratic process may be the strongest way to control governmental spending, but it is not a free standing objective itself. Democracies may therefore be justified in using a nondemocratic allocation mechanism to meet other competing values—for example, to better voice different preferences about the allocation of public goods. In the charitable relief context, this deviation is legitimate only if it is structured to simultaneously meet two objectives: mitigating the democratic decision-making allocation costs and not undermining the integrity of the majority’s tax-spending decisions.

Charitable relief promotes the first objective by making it less expensive for taxpayers to contribute and to “voice” those spending preferences which they feel are not fully accounted for by the majority. The act of contributing has a participatory value if it reflects on credible personal decisions about how to best allocate public funds to promote and prioritize different public goods. The value of contributions is therefore largely independent of a specific set of predetermined, quantifiable consequentialist objectives.

From a democratic perspective, charitable relief is problematic if it undervalues the voices of low-income individuals.¹²¹ The imperfections of the majority decision-making process impact the poor at least as much as the affluent. Furthermore, unlike high-income taxpayers, whose incomes by far exceed their basic consumption needs, low-income taxpayers tend to have little or no income surplus over their consumption. The willingness of the latter to contribute some of their relatively scarce financial resources to NPOs strongly suggests they consider NPOs’ activities as undersupplied. Hence, in a one-person, one-vote democracy, it is inconceivable that charitable relief provides only affluent taxpayers incentives to actively correct the outcomes of the governmental decision-making process. As serious as this concern is in the United States today,¹²² it challenges only charitable relief’s design and not the conceptual validity of its participatory value. For example, a charitable relief scheme could be designed as a partially refundable progressive credit that subsidizes the voices of low-income taxpayers in a greater proportion than the voices of affluent taxpayers. Consider a credit charitable relief in which the proportion of subsidy declines as taxpayers’ income increases—the credits would be partially refundable so that individuals with an annual income of less than \$20,000 would be eligible for a refundable credit of up to ninety percent of their contributions. Individuals whose annual income exceeds \$100,000 may only be eligible for a thirty-five percent credit.

This participatory opportunity requires individuals to subscribe to a number of conditions. First, they should invest some of their own resources to merit the subsidy.¹²³ Individuals’ willingness to incur out-of-pocket costs to promote their chosen objectives safeguards and validates (to a certain degree) the integrity of their decisions. Second, taxpayers applying for charitable relief should not receive any tangible benefit in return. Any type of quid pro quo transactions should not qualify for charitable relief. Taxpayers’ willingness to engage in these transactions simply

121. See Staudt, *supra* note 9, at 596.

122. As mentioned, in the United States, charitable relief provides tax benefits only to high-income taxpayers who itemize their deductions. It fails to provide any benefits to seventy percent of the less wealthy taxpayers who contribute funds to NPOs despite their relative scarcity of resources.

123. See Levmore, *supra* note 8, at 416.

suggests that a NPO sells something that they are willing to purchase, and not that they deem the NPO's exempt function as socially undersupplied.¹²⁴ As such, these contributions have no participatory value because donors engaged in giving them do not promote charitable relief's core function of determining the proper allocation of public funds. Given their inability to obtain omniscient knowledge about taxpayers' intentions and the market price of different commodities and services, tax authorities should deny charitable relief any time NPOs supply tangible goods or services in return for contributions. This is likely to include sponsorships, naming, and commemorative opportunities that are sold for a designated amount of money, and any other "contribution" for which tangible benefits are offered in return.

The above analysis runs contrary to the substance-subsidy justification's underlying paradigm. From a substance-subsidy perspective, procedural limitations (such as the quid pro quo limitation) are necessary only to the extent that they limit charitable relief's revenue impact, reduce its negative expressive value externalities, and make its administration feasible. Even though the dual subsidy analysis deemphasizes the substance-subsidy attributes of charitable relief, it incorporates these attributes rather than altogether rejects them. It swaps the traditional roles of the substance-subsidy and process-subsidy rationales. Accordingly, while the process rationale is at the core of the justification for charitable relief, the substance-subsidy approach offers important restrictions that ensure that charitable relief meets its second objective—not performing an antidemocratic function—which undermines the majority's tax-spending decision.

To ensure that charitable relief does not play an antidemocratic role, it should be subject to three types of limitations. First, it should not grant the opportunity to influence the allocation of public funds in a nonegalitarian manner. Hence, charitable relief should not disproportionately subsidize the voice of donors from certain groups—namely, high-income taxpayers. The reason for this is relatively straightforward. In a one-person, one-vote democratic regime, charitable relief should not be a tool that allows an avenue for plutocracy. Through the use of refundable credits (and even more

124. It may be naïve to expect complete enforcement of this requirement. The dual subsidy analysis adopts a more realistic benchmark than the formal legal requirement that taxpayers should contribute out of "detached and disinterested generosity." *Comm'r v. Duberstein*, 363 U.S. 278, 285 (1960). Though it remains good law, this rule has been deemphasized by the Supreme Court. *See Hernandez v. Comm'r*, 490 U.S. 680, 690–91 (1989). There, the Court preferred an objective quid pro quo test to the subjective test. *Id.* This objective test has been incorporated by the Treasury Department into the regulations governing this topic. *See* Treas. Reg. §1.170A-1(h) (as amended in 2005). This Article recognizes that contributions are rarely completely altruistic or benevolent and that donors obtain some intangible social benefits from them (e.g., satisfaction, respect, and prestige). Individuals may have mixed motives, and they may thus purchase tangibles and services from NPOs at an above-market price. The analysis becomes particularly complicated when NPOs offer unique goods and services not sold by any profit-seeking business, which renders it difficult to establish the market price. Ideally, tax authorities should try to bifurcate the components and grant charitable relief only to any above-market payments paid. However, as a matter of tax administration, tax authorities cannot always penetrate taxpayers' intentions or determine appropriate prices for different services. *See also* Colombo, *supra* note 3, at 668–79 (describing the paradox of altruism and the charitable relief scheme).

so the use of progressive refundable credits), charitable relief could be structured to address this problem.

Second, the amount of contributions that merit charitable relief should be limited. This is necessary to assure that the loss of revenues to the government do not require the majority to significantly change its tax and spending decisions. To maintain the integrity of the majority's spending decisions, the overall amount of charitable relief-related revenue losses should be constrained so as not to exceed a certain percentage of total revenues. Drawing this line is difficult as a conceptual matter but fairly easy from a tax policy perspective. Even in the United States, where charity plays a major role relative to other Western democracies, the revenue lost due to charitable relief constitutes only a small percentage of the federal budget.¹²⁵ The question becomes much more complicated, however, with regard to the majority's taxing decision. When laying a specific tax rate structure, the majority establishes not only the amounts it wishes to collect, but also the way in which it wishes to allocate the burden of financing the government's activities. Charitable relief reduces the effective tax rate of the donor. To overcome this problem, a limit should be set to determine how much of a given taxpayer's contribution should merit charitable relief. This limitation should be made in both absolute (numerical) and relative (proportional) terms to prevent circumventing the rate structure imposed by the majority. Drawing this line is not an easy task, and this Article refrains from addressing it fully. However, recent literature has provided some compelling answers to this vexing line-drawing question.¹²⁶

Finally, to keep charitable relief within a democratically acceptable framework, it should operate within substance-subsidy limitations. In the absence of these limitations, taxpayers could voice their spending preferences in a way that would run against, and potentially even refute, the majority decision-making process. For example, if taxpayers could allocate public funds via contributions to the Ku Klux Klan, this would jeopardize other public spending schemes intended to eliminate racism that were endorsed by the majority. This type of inconsistent public spending would be an inefficient—and in this case also immoral—use of public funds. The substance-subsidy restrictions may also help address the fiscal isolationism of certain minority groups, which have the incentive to better provide certain public goods exclusively to group members. This tendency would be of particular distributional concern if high-income groups are able to coordinate in this manner.¹²⁷ These are only two examples that

125. Fifty-six billion dollars is not a trivial amount; it exceeds the federal government's spending on its main welfare cash transfer program—the Earned Income Tax Credit (EITC). Nevertheless, fifty-six billion dollars comprises less than 1.7% of the total estimated federal tax receipts in 2008 and less than 1.5% of the combined budgets of federal (actual) receipts and estimated income tax expenditure budget. Charitable relief is also considerably smaller than other tax expenditures such as mortgage deductions and exemption of health benefits. *See* OMB REPORT, *supra* note 1, at 239, 296–99.

126. *See generally* Fleischer, *supra* note 3 (discussing the justifications for limiting charitable relief).

127. Let us assume that wealthy taxpayers were able to allocate public funds and reduce their tax liability via charitable contributions to any type of organization. This would enable a well-organized group of wealthy individuals to support NPOs that provide group members with benefits that do not have any positive externalities on nonmembers. This would erode the integrity of the tax system and reduce its progressivity.

demonstrate why the process rationales are not free standing and should be supplemented by substance-subsidy attributes.

According to the dual subsidy analysis, the majority determines the substance-subsidy restrictions on charitable contributions. The definition of charitable objectives should ideally align with the public good (and quasi-public good) analysis. These definitions are necessary but should nevertheless be broad enough to allow charitable relief to achieve its participatory objectives. For example, education is a quasi-public good because living in an educated society has positive externalities; however, the notion of what good education is may be subject to debate. In this sense, charitable relief is a method to supplement the majority's decisions for education because it allows taxpayers to allocate public funds toward different curricula. I do not mean to suggest that contributions toward promoting education are always consistent with each other or that using such a broad criterion may not result in abuse. These negative outcomes would offset if the majority of contributions allocated toward education produce the positive externalities associated with education. To endorse this notion, people do not have to agree upon the optimal curriculum but just agree that a very broad set of curricula share some of these externalities. The same analysis applies for other types of public goods—for example, public health, environmental protection, and poverty relief. Nevertheless, some recognized charitable objectives may lack these public good propensities. In art—and even more so religious services—it is not easy to account for the activity's positive externalities on nonparticipating third parties or upon society as a whole.¹²⁸ In these cases, even though the process-subsidy justification is satisfied, the substance-subsidy component may not be satisfied and in its absence the justification for charitable relief becomes uneasy.

IV. FROM THEORY TO PRACTICE: DEVELOPING A DUAL SUBSIDY ANALYSIS TOOL

The dual subsidy approach integrates the process-subsidy and substance-subsidy strands of justifying charitable relief to advance a more appealing normative justification. In doing so, the dual subsidy analysis can also contribute to the current debate about the practice of philanthropy and the role of charitable relief. Bluntly put, even though the dual subsidy justification this Article promotes does not rely on attributes of current practices, its insights can help create a better and more coherent charitable relief tax policy.

The dual subsidy justification is not only the proper way to justify charitable relief, but it also presents tax policymakers with the analytical scalpel to determine what transactions should qualify as charitable relief-worthy contributions. This determination is important because taxpayers engage with NPOs in a myriad of commercial and noncommercial ways. Charitable relief provides different parties with incentives to structure transactions as contributions to minimize their tax costs. Hence, the fundraising industry constantly pursues methods for broadening the definition of charitable relief-worthy contributions. Tax authorities cannot counteract these efforts

128. In a given society, it may be broadly agreed that religions do benefit society as a whole, and that this benefit is independent from any specific religious practices that one wishes to follow. This may even be true as an empirical observation. However, to date, I have failed to find any evidence suggesting that religious individuals contribute or inflict more or less costs on society than secular individuals do.

unless they develop a comprehensive and practical second-order rule to better implement the objectives of charitable relief. To prevent taxpayers from using charitable relief to erode their income tax base inappropriately, tax policymakers must first make the fundamental justifications of the subsidy clear. This Article provides a potential answer by offering a charitable relief qualification test that delineates a coherent and comprehensive framework to evaluate social practices that claim charitable relief. Specifically, it employs the dual subsidy approach to guide the interpretation of existing legislation. It states that charitable relief-worthy transactions should promote “good things”—meaning a general category of public goods—through a process that reveals that some donors consider these “good things” as socially undersupplied.

To substantiate the relevance of its analysis, this Article examines two important present-day case studies where charitable relief is granted despite a lack of substance-subsidy or process-subsidy justifications. The first case study evaluates the charitable relief worthiness of corporate contributions and concludes that the process-subsidy justification is not met when corporate managers contribute on behalf of their shareholders. As a result, extending charitable relief to corporate philanthropy is highly questionable. The second case study briefly analyzes whether tax authorities should extend charitable relief to contributions to religious NPOs. It articulates the difficulty with providing public support to the religious NPOs through charitable relief and frames this difficulty as a lack of substance-subsidy justification because religious activities could not be considered to be public goods. This analysis deviates from the constitutional framework through which this question is typically approached.

These case studies do not aspire to convince all readers that the answers it offers are panaceas in terms of finding “correct” solutions for every real world problem. The role of charity in society has always been a bone of contention, and, as a result, charitable relief’s proper scope has been debated fiercely over the years. This Article, however, offers a framework which identifies the sources of controversy with the charitable relief worthiness of different transfers to NPOs under its dual subsidy analysis. The dual subsidy analysis can also provide a solid analytic tool for understanding why granting charitable relief to some transfers is controversial. This would allow much more structured theoretical and policy debates. Given the growth in size and importance of the nonprofit sector in modern economies, developing this framework is imperative.

A. Case Study 1: Corporate Philanthropy

The current practice of corporate philanthropy lacks the participatory component needed to justify charitable relief. Managers making the contribution decisions are agents of corporations—which are investment vehicles—and not political agents of their shareholders. As such, they possess no special capacity to decide on behalf of their shareholders which public goods should go underprovided. The lack of a political agency diminishes the charitable relief worthiness of managers’ decisions to contribute on behalf of their corporate entities. However, tax law provisions regulating charitable relief can be reformed so that corporate philanthropy better subscribes to the process-subsidy justification.

1. The Lack of a Process-Subsidy Justification

In the United States, corporations are taxed independently of their shareholders. Similarly to the tax treatment of individuals, corporate charitable contributions were extended charitable relief in 1936 soon after the corporate income tax was enacted.¹²⁹ Corporations contribute to NPOs directly and through related charitable entities such as private foundations.¹³⁰ Because corporations and individuals are taxed as separate legal entities, tax policy and academic discourse implicitly assume that corporate and individual charitable contributions merit the same charitable relief. The dual analysis employed here rebuts this assumption. It suggests the prevalent academic discourse too hastily equates individual with corporate taxpayers. Even though the I.R.C. treats individuals and corporations as separate taxpaying entities, corporate charitable contributions do not merit charitable relief because they do not satisfy the process-subsidy justification. Corporations are investment vehicles that carry economic but not political agency relationships with shareholders. Accordingly, corporate contributions do not meet the process-subsidy attributes listed in Part III.

The value of I.R.C. § 170 charitable relief to shareholders that engage in philanthropy depends on the differences among the corporate, individual, and dividend tax rates. Determining the tax-saving value of deductible corporate charitable contributions to shareholders exhibits a complicated set of mathematical relationships among the different rates.¹³¹ The tax savings charitable relief provides to shareholders

129. Hayden W. Smith, *If Not Corporate Philanthropy, Then What?*, 41 N.Y.L. SCH. L. REV. 757, 757–60 (1997) (providing a brief history of the corporate philanthropy phenomenon).

130. Marsh, *supra* note 108, at 141; Sugin, *supra* note 88, at 144 (suggesting that this is a way that corporations address the claims that contributions represent an agency-cost problem and that this trend may come into conflict with a corporation's attempt to use its philanthropy strategy as part of its overall profit maximization strategy).

131. This Article's analysis refers to individuals subject to the top marginal tax bracket of 35% and whose shares in a corporation are subject to the top 35% corporate income tax rate. The dividends paid by the corporation are subject to a 15% tax rate. The three tax rates are hereinafter referred to as *I*, *C*, and *D* respectively. All numerical examples in this example are in millions of dollars. In a given fiscal year, an individual who is the sole owner of a holding corporation wishes to spend \$10 of her before-tax money that is invested in corporate form on her charitable contributions. If the corporation contributes \$10 out of its before-tax earnings to NPOs, the charitable relief is worth \$3.50 in tax saving to the corporation. Some of the corporate tax saving is captured when the corporation distributes dividends so that the tax benefit for the shareholder is \$2.975. However, if the corporation distributes the \$10 to the shareholders they are subject to corporate income tax and pay the shareholder \$6.50 in dividends. The shareholder will contribute this money and claim charitable relief. In the unlikely event that the shareholder has only dividend income, the charitable relief would save her \$0.975 in taxes (6.50×0.15). If she does have other income sources on which she pays *I* (35%), donating \$6.50 of her pre-tax income would save her \$2.275 in taxes. From the shareholder's perspective, it is more efficient that the corporation makes the contribution because it allows her to contribute more and save more taxes. This is true as long as $C/(1-C) > I$, which is always the case if $C > 50\%$ (and $100\% > I$). However, if the individual defers the dividend payment to a different fiscal year, and contributes \$10 out of her before-tax nondividend income, the charitable relief would save her \$3.50 in taxes, which is more tax savings than she could achieve by having the corporation make the contribution on her behalf. This will always be true as long as $I > C * (1 - D)$.

is determined also by their absolute amounts of noncharitable itemized deductions and nondividend income.¹³²

From the shareholders' perspective, the desirability of corporate contributions is further contingent upon their ability to control management's contribution decisions. Indeed, much of the academic literature about corporate philanthropy addresses whether contributing should be aligned with management's obligation to maximize shareholders' welfare.¹³³ Corporate and tax law academics have found the corporate philanthropy phenomenon intriguing because of the way different legal doctrines manifest themselves through it. The dilemmas associated with corporate philanthropy exhibit how different issues—such as NPOs and corporate governance, government and private-sector/corporate responsibilities—inevitably intersect and conflict.¹³⁴ Opinions on this matter vary considerably. Some scholars argue that corporate philanthropy always represents an agency problem because it defies shareholders' wealth maximization interests, and that tax law should not subsidize this agency cost.¹³⁵ Other scholars argue that corporate contributions harmonize with shareholders' enlightened long-term interests, allowing them to do well by doing good. This position requires corporate philanthropy to “get in between the horns of a rather difficult dilemma”¹³⁶ because once the transfers of funds to NPOs become too bluntly self-interested, they may not qualify as *charitable* contributions.¹³⁷ Another opinion stresses that corporate philanthropy manifests corporations' social responsibility, which is a supplementary (or competing) goal to management's obligation to maximize the economic welfare of their shareholders.¹³⁸ This problem is not unique. Shareholders

Thus, when the individual and dividend tax rates decrease and corporate tax increases, it is more profitable from the shareholder's perspective to have the corporation contribute for her. See Sugin, *supra* note 88, at 129–34 (claiming that the current rate structure resulted in an unintentional bias in favor of corporate philanthropy).

132. In the current rate structure, if the shareholder has enough nondividend income to cover her charitable and noncharitable expenses, is not subject to the alternative minimum tax, and can defer the dividend income, it is more tax-efficient for her to make the contribution directly and not through her corporation. These different conditions are very unlikely in the case of many affluent taxpayers—who are subject to the alternative minimum tax (which may deny them the charitable relief altogether) and have a high proportion of dividend income and capital gains as a cash flow that supports their expenses.

133. See generally Melvin Aron Eisenberg, *Corporate Conduct That Does Not Maximize Shareholder Gain: Legal Conduct, Ethical Conduct, the Penumbra Effect, Reciprocity, the Prisoner's Dilemma, Sheep's Clothing, Social Conduct, and Disclosure*, 28 STETSON L. REV. 1 (1998) (surveying the different explanations for why the conduct of corporate philanthropy is not a per se violation of managers' fiduciary obligations towards shareholders).

134. See generally Kahn, *supra* note 5.

135. See Sugin, *supra* note 88, at 125.

136. RICHARD EELS, CORPORATION GIVING IN A FREE SOCIETY 7 (1956).

137. Nancy J. Knauer, *The Paradox of Corporate Giving: Tax Expenditures, The Nature of the Corporation, and the Social Construction of Charity*, 44 DEPAUL L. REV. 1, 79 (1994); see also Victor Brudney & Allen Ferrell, *Corporate Charitable Giving*, 69 U. CHI. L. REV. 1191, 1195 (2002).

138. Margaret M. Blair, *A Contractarian Defense of Corporate Philanthropy*, 28 STETSON L. REV. 27–28 (1998); Joannie Chang, Jennifer I. Goldberg & Naomi J. Schrag, *Cross-Border Charitable Giving*, 31 U.S.F. L. REV. 563, 581 (1997) (saying that corporations bear an inherent responsibility to society and the community in which they operate because of their dependency on its protection and infrastructure and suggesting that corporate philanthropy may be an

rationally agree to invest in equities of corporations that they do not control. They choose this investment pattern knowing that the benefits of professional management and risk diversification outweigh their agency costs. Corporate contributions are yet another type of agency cost that well-informed investors take into account prior to investing in corporate equity.¹³⁹ The question of whether corporate theory justifies corporate contributions is therefore insignificant from a tax perspective.

This Article deviates from this discourse and argues that corporate charitable contributions pose a different type of tax agency problem. To determine whether corporate contributions merit charitable relief, policymakers should first assess whether the contributions meet the justifications for charitable relief. Under the dual subsidy analysis, corporate contributions meet the substance-subsidy justification to at least the same extent that identical individual contributions would. Managers command a great pool of resources on behalf of many individual and corporate shareholders. Fundraisers may find it easier to raise money from a few managers than from a diffused and anonymous shareholder body. Corporations can also invest more resources in selecting philanthropic projects and in monitoring the performance of NPOs. The multinational scope of many corporations also puts them in a better position to support large-scale activities in more than one country. Accordingly, corporations' ability to attain collecting, spending, and informational efficiencies to promote charitable objectives is probably greater than the aggregate ability of their shareholders.¹⁴⁰

Nevertheless, corporate charitable contributions contradict the process-subsidy justification rationale because the manager-shareholder affiliation is not a viable political relationship. Managers have superior knowledge about maximizing corporate performance but have no advantage in assessing which public goods are underprovided. Furthermore, consolidating shareholders' interests into managers' hands contradicts the process rationale. This rationale requires diffusing the contribution decision to allow broader participation by individuals who wish to express their political preferences as to which public goods are undersupplied by the state. Having managers make centralized contribution decisions on behalf of shareholders takes away some of the assumed benefits of having a decentralized process to supplement the centralized democratic process.¹⁴¹ Moreover, the process-subsidy justification suggests that a government's willingness to delegate allocation and budgetary decisions through the contribution process does not imply that individuals could delegate this political agency to managers. The process-subsidy justification values individuals' decisions because *they* make them in the same way that the electoral process values their ballots because they vote with them.¹⁴² It is therefore not clear whether shareholders are able to concede their political rights to managers.¹⁴³

adequate way of fulfilling this responsibility); Dillon, *supra* note 5, at 4–5.

139. Blair, *supra* note 138, at 29–32.

140. *E.g.*, Henry N. Butler & Fred S. McChesney, *Shareholder Welfare and Corporate Philanthropy in the Contractual Theory of the Corporation*, 84 CORNELL L. REV. 1195, 1203–05 (1999) (arguing that shareholders may prefer to contribute from the office because it reduces their transaction costs); Eisenberg, *supra* note 133 (suggesting different ways in which corporate contributions may be perceived as maximizing the welfare of its shareholders and the broader social welfare).

141. Brudney & Ferrell, *supra* note 137, at 1208.

142. *See id.* at 1206.

143. This analysis is very different than the case of the contributions made to large NPOs

Furthermore, most shareholders—especially portfolio investors—do not consider managers of corporations as their political agents.¹⁴⁴ From a tax perspective, corporate contributions cannot fulfill their participatory function of determining what social causes deserve more spending than what has been allocated to them under the majoritarian process.

Opponents of this analysis may insist that corporate contributions allow second-order pluralism. If different corporations have different contribution objectives, they would support different NPOs, which would have the same impact as if different individuals made the contributions. This argument is misleading in two important respects. First, corporate managers' salaries typically place them at the top end of social wealth distribution.¹⁴⁵ Correspondingly, to the extent that corporate contributions reflect on managers' discretion of what public goods are undersupplied, this discretion is likely to correspond with elite preferences.¹⁴⁶ As explained below, many corporations tend to use contributions as a form of advertisement. Therefore, most corporations are likely to target the upper-middle class, which holds the lion's share of consumption capacity.¹⁴⁷ By imitating their consumers' charitable preferences, corporations fail to express the preferences of other social segments. These attributes significantly reduce the chances that corporate contributions promote second-order pluralism. Second, as mentioned above, the process-subsidy justification does not seek to encourage pluralism as an end result. To the extent that pluralism and diversity are undersupplied social goods, corporate philanthropy's contribution to the promotion of second-order diversity strengthens its substance-subsidy attributes. However, it adds nothing to the process-subsidy justification analysis. Like redistribution and other policy objectives that may be considered as public goods, pluralism is a plausible end result of charitable relief, but not part of its participatory function.

To best understand why corporate charitable contributions fail to meet the process-subsidy requirements, we must examine why corporations *really* contribute to NPOs. The issue of corporate philanthropy is puzzling because in a competitive market,

that donate the money to other NPOs—for example, the United Way (UW). Unlike corporations, the UW has political agency—that is, donors know what type of activities the NPO funds and may direct their money to specific activities. They are using the UW to better monitor and diversify their charitable giving but they are making the decision to which activities to contribute. In the case of corporations, shareholders are conceding their political participatory authority to a manager whom they elected primarily based on her business performance and not because they think she is a better decision maker for deciding how to allocate public funds.

144. Jill E. Fisch, *Questioning Philanthropy from a Corporate Governance Perspective*, 41 N.Y.L. SCH. L. REV. 1091, 1105 (1997).

145. AFL-CIO, 2008 Executive PayWatch, <http://www.aflcio.org/corporatewatch/paywatch/>.

146. See Brudney & Ferrell, *supra* note 137, at 1209 (arguing that corporate managers come from a narrow and potentially different segment of society and that a pluralist set of objectives for charitable giving is more likely to be served if it is established by a more diverse group of individuals); Fisch, *supra* note 144, at 1105 (suggesting the attributes that qualify corporate executives to manage corporations are not obviously linked to the ability to identify social needs and structure spending decisions to attend to those needs).

147. For example, consider Target's recent campaign in supporting free access to museums. See Target, Community Sponsored Happenings, <http://sites.target.com/site/en/corporate/page.jsp?contentId=PRD03-002065>. The correlation between supporting art and public relations was recognized early. See Gavin K. MacBain, *The Philosophy of Corporate Philanthropy*, TAX POL'Y, Feb. 1972, at 3, 5–6 .

corporations would not be able to afford to make any such contributions. These extra expenses would increase their cost of capital and prevent them from competing efficiently with other firms. Therefore, one would expect corporations, when given the choice, to reject corporate giving. This relatively straightforward analysis is poor in predicting corporate philanthropic behavior, however. In recent years, corporate philanthropy has been increasing, suggesting that corporations are able to compete effectively despite it.¹⁴⁸ In an era characterized by constant attempts to reduce government spending, the role of corporations in directing public and private funds toward charitable purposes enjoys a growing legitimacy and NPOs' demand for corporate contribution soars.

One explanation for this is that to the extent corporate philanthropy represents an agency cost, it is one that involves relatively small amounts of money. Given market imperfections, shareholders of a profitable firm may endure this cost. However, the more likely explanation is that corporations' charitable contribution policies do not represent benevolent generosity, but a conditional one that is legitimate only to the extent that it could be integrated with corporate profit maximization policies.¹⁴⁹ The literature identifies a number of different methods through which corporations invest in charitable projects to improve their consumer-based intangibles and workforce.¹⁵⁰ For example, a corporation may use contributions to establish a better long-term work relationship with its present or future employees. Contributing to NPOs that operate in the communities of its employees, or to an academic institution (whose graduates comprise an attractive pool of potential employees) would facilitate the corporation's efforts to recruit and retain high-quality employees.¹⁵¹ For example, big corporations and financial firms may find it beneficial to contribute to leading business schools. Additionally, corporations use charitable contributions as a form of long-term advertisement to improve their image and increase their consumer base.¹⁵² The corporation's charitable giving also helps it diversify its advertisement strategy.¹⁵³ A

148. Brudney & Ferrell, *supra* note 137, at 1197; Ken Milani & James L. Wittenbach, *Charting the Provisions of the Charitable Contribution Deduction for Corporations*, 13 TAX'N EXEMPTS 125, 125 (2001); Christine M. Petrovits, *Corporate Sponsored Foundations and Earnings Management*, 41 J. OF ACCT. & ECON. 335, 337–38 (2006); Baruch Lev, Christine Petrovits & Suresh Radhakrishnan, *Is Doing Good for You? Yes, Charitable Contributions Enhance Revenue Growth* (N.Y. Univ., Working Paper No. BARUCH LEV-04, 2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=920502 (suggesting causation between corporate charitable contributions and future increases in corporate revenues).

149. See, e.g., Eisenberg, *supra* note 133 at 25–26 (arguing that activities appearing to be nonmaximizing and not legally or ethically required are actually consistent with maximization principle); Knauer, *supra* note 137, at 4.

150. See generally Knauer, *supra* note 137 (providing a comprehensive analysis of these reasons).

151. Faith Stevelman Kahn, *Pandora's Box: Managerial Discretion and the Problem of Corporate Philanthropy*, 44 UCLA L. REV. 579, 672–73 (1997); Lev et al., *supra* note 148.

152. See Kahn, *supra* note 151, at 579 (providing a taxonomy of the different advertisement benefits that corporations seek to obtain through contributions); Lev et al., *supra* note 148 (claiming that corporate contributions increase customer loyalty and brand awareness).

153. Brudney & Ferrell, *supra* note 137, at 1196 (arguing that corporate cash contribution functions predominantly to build a favorable corporate image); Frances R. Hill, *Corporate*

corporation associated with the advancement of a specific charitable objective will have increased goodwill among potential consumers that value this objective. For example, the recent increase in awareness of environmental issues—like global warming—explains why many corporations have recently started to invest in “green” projects.¹⁵⁴

Even though contemporary corporate philanthropy practices have more to do with business than with benevolence, corporations can obtain several tax advantages if their expenses are characterized as charitable contributions under I.R.C. § 170.¹⁵⁵ Most notably, the classification of expenses as charitable contributions allows an immediate deduction of all charitable expenses.¹⁵⁶ This deductibility may not have been as easy to achieve if corporations had tried to classify these same expenses as ordinary business expenses under I.R.C. § 162.¹⁵⁷ In many instances contributions promote long-term consumer-related intangibles. When taxpayers invest in new assets they typically are not allowed to deduct their expenses immediately but are required to capitalize them and amortize them over time—fifteen years in the United States.¹⁵⁸

Corporations may also have other good tax reasons to prefer I.R.C. § 170 charitable deductions over ordinary business deductions. To expedite their deductions without losing control over their money, corporations can also channel the charitable contributions to private foundations and support organizations.¹⁵⁹ To the extent that

Sponsorship in Transactional Perspective: General Principles and Special Cases in the Law of Tax Exempt Organizations, 13 U. MIAMI ENT. & SPORTS L. REV. 5, 11–13, 20, 58–61, 77 (1995) (laying down the analytical considerations for when corporate sponsorship should be considered as a charitable contribution that merits charitable relief, describing the landmark case that initiated a regulatory process in which the IRS retreated from its position and allowed more lax standards to permit corporate sponsorship to qualify for charitable relief); see also Petrovits, *supra* note 148 (citing different studies that establish a relationship between advertisement and corporate giving).

154. *A Change in Climate: The Greening of Corporate Responsibility*, in ECONOMIST: JUST GOOD BUSINESS: A SPECIAL REPORT ON CORPORATE SOCIAL RESPONSIBILITY 14, 14 (2008); Sugin, *supra* note 88, at 126 (arguing that in the post-Enron world, corporations use philanthropy to burnish their public image).

155. See generally Milani & Wittenbach, *supra* note 148 (discussing different tax advantages).

156. *Id.* at 129–30 (discussing the incentives in the I.R.C. for corporations to donate ordinary income scientific property to universities for the use in research endeavors).

157. I.R.C. § 162 (2006).

158. See I.R.C. §§ 170, 197 (2006); Treas. Reg. § 1.162-1(a) (as amended 1993); Treas. Reg. § 1.162-20(a)(2) (as amended 1995) (stating that advertizing and even expenses invested in goodwill are generally deductible as ordinary and necessary business expenses provided the expenditures are related to the patronage the taxpayer might reasonably expect in the future); Sugin, *supra* note 88, at 171–75 (suggesting that this issue is not as compelling today as it was in the past since recent regulations took away most of the teeth of the INDOPCO’s capitalization requirement).

159. Let us suppose that a corporation wants to allocate ten million dollars over the course of the next five years for green projects. By doing so, they would increase the visibility of their products to upper-middle-class consumers. Let us further assume that because of various reasons the corporation has a relatively high tax liability in a given fiscal year. Rather than deducting the payments during the course of the five-year period, the corporation establishes a private foundation or a support organization and channels the money to it to get the deductions when the timing is most convenient. Although foundations and support organizations operate under

corporations donate appreciated assets—including, in some cases, inventory—they may double dip their tax advantage.¹⁶⁰ Finally, contributions allow corporations to purchase political influence with pre-tax dollars and to avoid political controversy. Corporations are large actors with significant stakes in the economy that have a myriad of interests in the political process and the way that government rules affect their profitability.¹⁶¹ In the United States, tax law disallows the deduction of lobbying expenses as ordinary and necessary business expenses. The deduction of campaign contributions is also disallowed.¹⁶² Through conduit transactions to NPOs affiliated with certain political ideologies and parties, corporations can use charitable relief as an avenue for gaining political influence and avoiding restrictions on lobbying.¹⁶³ Because tax authorities lack the enforcement capacity necessary to effectively deter and to detect most conduit contributions, this method of lobbying has obvious business advantages. Furthermore, given the covert nature of these transactions, the public may not know the identity of the speakers engaged in the political debate.¹⁶⁴ This is antithetical to basic democratic participation norms which exclude corporations and their managers from having any special status in the voting and decision-making process.

The above tax advantages extend to all taxpayers and not merely to corporations. Nevertheless, the concerns expressed with regard to charitable relief's tax advantages are particularly troubling when corporations exploit them—in particular with regard to conduit political lobbying transactions. Corporations aggregate the wealth of many individuals; therefore, they can be viewed as large, well-advised taxpayers in a good position to maximize all these benefits.

In summary, corporations engage in charitable contributions for an amalgam of reasons. This amalgam combines managers' desire to purchase personal intangible benefits by using corporate assets with their ability to use these contributions for the benefit of the corporation and its shareholders. However, none of these reasons correspond with the process-subsidy justification. Therefore, tax authorities should, first and foremost, deny charitable relief to corporate contributions even if they are "benevolent" and reflect genuinely upon managers' charitable preferences as to what public goods are undersupplied. This has nothing to do with the traditional corporate

certain restrictions, this simple strategy allows corporations to control the timing of their deductions. Treacy, *supra* note 110, at 387.

160. The contribution classification allows them to avoid paying taxes on the unrealized profits and to deduct the FMV of the donated assets. Sugin, *supra* note 88, at 156–61.

161. See generally Reuven S. Avi-Yonah, *Corporations, Society, and the State: A Defense of the Corporate Tax*, 90 VA. L. REV. 1193 (2004) (linking the corporate tax to the attempt to limit corporate managers' power).

162. I.R.C. § 162(e) (2006). Taxpayers may nevertheless take part in conduit transactions where they donate to an NPO (under I.R.C. § 501(c)(3) (2006)) that donates to a welfare organization under I.R.C. § 501(c)(4) (2006), that then transfers the money to a political organization as defined in I.R.C. § 527 (2006). See Miriam Galston, *Campaign Speech and Contextual Analysis*, 6 FIRST AMENDMENT L. REV. 100 (2007) (providing an illuminating analysis over the regulation of tax exempt networks). In my opinion, the author underestimates the ability of tax-deductible charitable contributions to leak to I.R.C. § 527 organizations because her analysis refers only to very "closely-held" networks.

163. See Fisch, *supra* note 144, at 1102; Frances R. Hill, *Exempt Organizations as Corporate-Candidate Conduits*, 41 N.Y.L. SCH. L. REV. 881, 882–89 (1997).

164. See Hill, *supra* note 163, at 939–40.

law analysis that suggests that managers' philanthropic activity with shareholders' money represents a socially undesirable agency cost. From a tax perspective, the process-subsidy justification requires an explanation of why managers' preferences should receive a supra-preferential tax treatment¹⁶⁵ and why the government should subsidize the political decisions managers make with their shareholders' money. Managers are not political agents of their shareholders; they obtain no better knowledge of what social goods are underprovided and they tend to come from a relatively thin privileged social class. Second, if corporate charitable contributions reflect corporate business expenses, they should be treated as such, deducted or capitalized as appropriate. Third, charitable relief should not help corporations purchase political influence, especially if election laws restrict such a purchase. There are good reasons, therefore, to deny corporate contributions charitable relief on the grounds that it defies rather than promotes the process-subsidy justification.

Nevertheless, it is difficult to deny that corporate scope and scale may more effectively promote charitable objectives because corporations are better positioned to improve NPOs' collecting, spending, and information efficiencies. However, corporate philanthropy is not a free good. As discussed above, its costs reinforce the need to reconsider whether its social benefits outweigh its social costs.

2. An Alternative Model

For the reasons stated above, the current practice of corporate philanthropy is theoretically indefensible. Tax law should deny charitable relief to corporations' charitable contributions and instead determine their tax treatment using the same analytic tools of general business expenses.¹⁶⁶ This would increase tax revenues by requiring corporations to amortize some of their contributions, disabling them from using conduit entities such as private foundations to accelerate deductions, and preventing them from double dipping by donating appreciated assets. Furthermore, when corporations contribute merely to advertise in a way unrelated to NPOs' exempt functions, the IRS should consider taxing NPOs on these payments.¹⁶⁷ Once these types of contributions are disallowed, they would find it harder to construct conduit transactions to buy political influence in a cheap and covert way.

These, however, are not the only plausible results. It is possible to alter charitable relief requirements so that the practice of corporate philanthropy subscribes to the process-subsidy justification and becomes consistent with the dual subsidy approach. This may be the more appropriate avenue for reform given the explicit legislative extension of charitable relief to corporate charitable contributions, their potential efficiency advantages, and the uphill political battle necessary to altogether deny charitable relief.

165. Brudney & Ferrell, *supra* note 137, at 1206; Fisch, *supra* note 144, at 1105.

166. See generally Sugin, *supra* note 88 (providing an excellent analysis leading to this conclusion).

167. The I.R.C. imposes an unrelated business income tax (UBIT) on the business activities of NPOs that are unrelated to their exempt function. To the extent that an NPO receives payments tantamount to commercial advertisement, it should be subject to the UBIT. See Knauer, *supra* note 137, at 92–93.

One possible solution is to put the decision-making process over the corporate philanthropic strategy in the hands of individual shareholders.¹⁶⁸ If the individual (and not corporate) shareholders of a corporation approve the corporation's charitable contribution decisions and directly bear some of their costs, the process-subsidy rationale would be fulfilled. Management should approve charitable contributions through some mechanism of shareholder voting. This would preserve some of the benefits of having a centralized management explore different contribution alternatives and monitor different contribution investments on behalf of its shareholders, while instituting a more democratically accountable framework. Formulating an effective shareholder voting mechanism, however, is a complicated project that requires structuring disclosure requirements and a voting technique that ensures it is more than a rubber stamp.¹⁶⁹ Such a process may also have a positive impact on the practice of corporate philanthropy from a corporate governance perspective.

This issue is beyond the scope of the current Article. Nevertheless, it is important to stress that this Article's analysis does not prescribe the disallowance of charitable relief to any type of corporate contribution. It only suggests that to merit charitable relief, the corporate charitable contribution process should align with the core rationales that support providing preferential tax treatment for charitable contributions.

B. Case Study 2: Charitable Relief Worthiness of Contributions to Religious NPOs

Under the Article's dual subsidy analysis, many aspects of charitable relief granted to contributions made to religious organizations may not qualify for a substance subsidy. It is highly controversial whether, in a liberal democracy, religious activities that do not have any proven positive externalities on the general public merit charitable relief's tax subsidy. While I do not debate the externalities here,¹⁷⁰ I point out that the case for charitable relief becomes particularly tenuous when religious organizations engage in activities that, apart from possibly not having positive externalities on the general public, are also not purely religious. The most relevant contemporary example is when religious organizations engage in partisan political activity.¹⁷¹ In the 2004 presidential election, the IRS took measures to deny charitable relief to various churches' donors when those churches had engaged in partisan political activity.¹⁷²

168. See also Brudney & Ferrell, *supra* note 137, at 1209–10 (engaging in a preliminary discussion regarding the feature of a regime in which shareholders make contribution decisions for the corporation); Sugin, *supra* note 88, at 161 (pointing out that Berkshire Hathaway had such a program that addressed agency cost issues and provided its shareholders with the tax advantages).

169. Smith, *supra* note 129, at 769 (1997) (stressing the lack of comprehensive disclosure rules on these issues).

170. I consider questioning the charitable relief-worthiness of contributions made to religious organization as detached from any realistic political agenda.

171. This objection to lobbying applies to all tax-exempt organizations and not only to religious organizations.

172. I.R.C. § 503(c)(3) denies the tax-exemption for NPOs; I.R.C. § 503(c)(4) denies charitable relief from contributions made to tax-exempt social welfare organizations that are allowed to lobby. See Steffen N. Johnson, *Of Politics and Pulpits: A First Amendment Analysis of IRS Restrictions on the Political Activities of Religious Organizations*, 42 B.C. L. REV. 875,

This issue can be understood as a lack of substance subsidy. As long as political expression is not considered a charitable relief-worthy objective, the IRS was right in limiting charitable relief to contributions made to religious NPOs that were engaged in political activity.

As in most Western countries, United States tax legislation recognizes contributions to religious NPOs as meriting charitable relief. In the United States, individuals contribute to religious NPOs more than to all other charities.¹⁷³ This Article approaches the charitable relief worthiness of these contributions with caution, because there may be compelling constitutional justifications for why these contributions qualify for charitable relief.¹⁷⁴ These justifications rest on constitutional theory arguments uniquely tailored to the special historic and social role of religious NPOs in a given society and deviate from classical substance-subsidy justifications.¹⁷⁵ A United States constitutional analysis may be irrelevant in the context of most Western European countries, where there is less emphasis on a separation of church and state, and where governments directly finance religious institutions.¹⁷⁶ This Article proceeds by demonstrating how its dual subsidy analysis helps examine charitable relief for contributions made to religious NPOs.

It is not clear that NPOs providing religious services or promoting the arts benefit society as a whole. In the case of art, many of the NPOs promoting it may also qualify

878–80 (2001); Meghan J. Ryan, *Can the IRS Silence Religious Organizations?*, 40 IND. L. REV. 73, 79–80 (2007); Allan J. Samansky, *Tax Consequences When Churches Participate in Political Campaigns*, 5 GEO. J.L. & PUB. POL'Y 145, 156–59 (2007).

173. Gergen, *supra* note 7, at 1434.

174. Jennifer M. Smith, *Morse Code, Da Vinci Code, Tax Code and . . . Churches: An Historical and Constitutional Analysis of Why Section 501(c)(3) Does Not Apply to Churches*, 23 J. L. & POLITICS 41, 72–84 (2007) (suggesting such analysis with regard to religious NPOs' political speech).

175. They claim that religious NPOs enjoy special sovereignty prerogatives for which they should be excluded from the tax base to prevent government influence. Edward A. Zelinsky, *Are Tax "Benefits" for Religious Institutions Constitutionally Dependent on Benefits for Secular Entities?*, 42 B.C. L. REV. 805, 807, 811 (2001) (claiming that by exempting religious NPOs governments do not give them a subsidy but just leave them alone). Zelinsky's work partially relies on the general tax-exemption justification provided by Brody, who claims that the exemption keeps government out of the day-to-day business of charities. See Evelyn Brody, *Of Sovereignty and Subsidy: Conceptualizing the Charity Tax Exemption*, 23 J. CORP. L. 585, 586, 593 (1998). I find Brody's justification unpersuasive. The tax authorities are so invested in keeping the tax-exemption within its limit that they are invested in regulating the day-to-day business of charities. Some commentators have observed that private charities should be regarded as regulated industries due to this regulation. Moreover, given lax state-attorney supervision of NPOs, tax authorities are the prime regulators of charities and, unlike private businesses where tax authorities only assess the outcomes of the business activity, they retain much more power over how NPOs structure their activities. See generally John D. Colombo, *In Search of Private Benefit*, 58 FLA. L. REV. 1063 (2006) (discussing the private benefit doctrine that polices economic transactions between tax-exempt charities and for-profit entities as a way to assure that charity assets are not drained or wasted; this type of legal rule is not necessary in the for-profit sector); Simon et al., *supra* note 3, at 267 (stating that over the years America has come to entrust to the tax system a central role in the nourishment and regulation of the charitable sector).

176. See generally STATE AND CHURCH IN THE EUROPEAN UNION (Gerhard Robbers ed., 1996) (providing a comprehensive survey of the state-church relationship in different EU countries).

as providing education. Additionally, cultural institutions can also be seen as having positive externalities on urban communities (such as encouraging tourism).¹⁷⁷ If policymakers accept either of these public good characteristics, it is very rational to provide art with public subsidies.¹⁷⁸

In the case of religion, however, the substance-subsidy justification is more difficult to accept. Different religions not only compete, but they also may conflict with each other, may have little in common, and are a byproduct of individual preferences. Religious services are therefore ideal for rivalrous and exclusive consumption.¹⁷⁹ It is possible, of course, that religious services benefit society because they encourage individuals to apply higher moral standards. However, this is questionable as an empirical matter, and in any event evaluating the public value of particular religious teachings is beyond the government's authority in most Western nations. Indeed, it is just as easy to argue that the reverse is true.¹⁸⁰ Without such evidence, advocating that a specific religion, or that organized religions in general, merits a state subsidy imposes a great burden to demonstrate that there is some benefit to third parties. To be clear, this Article does not assert that such an argument could not be made; it just points out that it has not been made yet in the charitable relief context. NPOs affiliated with different organized religions supply many public goods such as education, health, human services, and poverty relief. There is no dispute that when NPOs that are affiliated with a specific religious congregation fulfill these functions, they merit charitable relief under the substance-subsidy justification. Historically, at the time in which the income tax and charitable relief were first enacted in the United States, NPOs had a prominent role in providing public goods. This historic involvement may partially account for legislators' decision to extend charitable relief to contributions made to religious NPOs. In this respect, religious schools should qualify as charitable NPOs because they promote education. The center of gravity of the present inquiry is whether NPOs providing religious services merit charitable relief.

This Part assumes that there is little ground for considering religious activities as undersupplied public goods in a liberal democracy. The logical derivative of this assumption is that contributions made to NPOs providing religious services should not be granted charitable relief because extending charitable relief to support them inflicts costs on individuals that are not parish members of any organized religion. Law is not the art of logic, however. In the United States, I.R.C. § 170 explicitly mentions that contributions to NPOs primarily engaged in religious activities should be granted its charitable relief deduction. Given the explicit legislative language, this Article refrains from tackling charitable relief for contributions made to religious NPOs.

177. Henry Hansmann, *Nonprofit Enterprise in the Performing Arts*, 12 BELL J. ECON. 341, 342 (1981).

178. The consumption of art is not rivalrous or exclusive, for the most part (my enjoyment of the painting is not reduced by the fact that millions have seen it before me). In the case of performing arts, however, there are other problems related to the enormity of fixed costs and the inability to price discriminate. *See generally id.*

179. Allan J. Samansky, *Deductibility of Contributions to Religious Institutions*, 24 VA. TAX REV. 65, 75–77 (2004).

180. For example, religious services might tend to make people less tolerant, which could be considered a negative externality in a multicultural society with religious diversity.

However, as mentioned in Part II.A., the legislative language of I.R.C. § 170 does not provide any theory that helps determine what comprises religious activities. To fill this void, this Article scrutinizes the proper scope of charitable relief to religious NPOs through its dual subsidy lens. In the absence of any substance-subsidy justification, the IRS and tax policy makers should construe the wording of I.R.C. § 170 narrowly to include only religious, spiritual activities. It should not include other ancillary activities.

The most relevant ancillary activity that has surfaced in the public debate is the ability of religious NPOs to engage in partisan political activities. Tax legislation restricts exempted NPOs from lobbying and prohibits them from promoting political candidates and engaging in partisan political activities.¹⁸¹ This legislative amendment primarily targets religious NPOs because of their tendency to play an active role on various issues that are part of the political agenda.¹⁸² The 2004 presidential elections drew attention to this restriction because many churches actively supported different presidential candidates.¹⁸³ As a result, the IRS announced its intention to enforce the restriction more strictly.¹⁸⁴ The media coverage following this announcement sparked a scholarly controversy of whether tax authorities have the practical ability, conceptual foundations, and constitutional authority to distinguish political from religious activities.¹⁸⁵

This Article's analysis refrains from debating whether religious NPOs engaged in political activities should retain their tax-exempt status. Furthermore, given that contributions made to religious NPOs generally merit charitable relief, enforcing the restriction on partisan political activity is problematic as a matter of tax administration. Such enforcement requires the IRS to monitor and assess what has been said in services. Given the limited resources the IRS can devote for such an enforcement enterprise, the problem of selective enforcement by the executive branch surfaces.¹⁸⁶

181. See I.R.C. § 503(c)(4) (2006).

182. See generally Patrick L. O'Daniel, *More Honored in the Breach: A Historical Perspective of the Permeable IRS Prohibition on Campaigning by Churches*, 42 B.C. L. REV. 733 (2001) (claiming that the legislative amendment was motivated by President Johnson's fear that churches would oppose his candidacy).

183. Chris Kemmitt, *RFRA, Churches and the IRS: Reconsidering the Legal Boundaries of Church Activity in the Political Sphere*, 43 HARV. J. ON LEGIS. 145, 156–59 (2006).

184. See INTERNAL REVENUE SERV., TAX GUIDE FOR CHURCHES AND RELIGIOUS ORGANIZATIONS (2006).

185. See generally Richard W. Garnett, *A Quiet Faith? Taxes, Politics, and the Privatization of Religion*, 42 B.C. L. REV. 771 (2001) (suggesting that the prohibition on political activity unduly interferes with their affairs); Kemmitt, *supra* note 183, at 176–77 (arguing that the prohibition is too vague and that there is a need for a bright-line rule that would allow the IRS and religious NPOs to distinguish clearly between permissible and impermissible NPO participation in political activities; this would reduce costs of uncertainty and costs of tax enforcement).

186. Lloyd H. Mayer, *Grasping Smoke: Enforcing the Ban on Political Activity by Charities*, 6 FIRST AMENDMENT L. REV. 1, 3–5 (2007) (providing illuminating evidence for the deficient IRS enforcement on this issue); Smith, *supra* note 174, at 41, 47–51, 59–61 (providing examples from the 2004 presidential elections and raising the claim that the IRS had a disturbing tendency to inquire about the political activity of liberal churches).

What this Article does suggest, is that the lack of a substance-subsidy justification for contributions made to religious NPOs makes the case for their charitable relief-worthiness tenuous to begin with. Therefore, since it is already difficult to justify charitable relief to religious NPOs as promoting the provision of general public goods, the statutory language should not be extended to activities merely associated with religious affiliation. Religious NPOs and political parties may advocate similar ideas, and religious activists may seek to promote their ideas by engaging in political activity. However, it seems odd to argue that religious activities inherently require political activity. Therefore, this Article's dual subsidy analysis suggests that contributions made to religious NPOs engaged directly or indirectly in nonreligious political activities provide a perfect example of a lack of substance-subsidy justification.

This observation helps to frame the debate of whether charitable relief should be granted to these contributions. A survey of the current debate over whether churches should be denied charitable relief for engaging in political activity indicates that people on both sides of the barricade are arguing over different things. The IRS essentially argues that charitable relief should not directly or indirectly channel money to political campaigns because the support for a specific candidate competing for office is not a public good. From this perspective, it is unclear why taxpayers should subsidize the political activities of a religious NPO if they support different candidates and agendas. IRS critics implicitly argue that the political speech of religious NPOs is a public good. This thought is certainly not absurd and should be addressed explicitly. In many Western democracies, the existence of a public forum in which citizens can engage in political debate is considered a public good worthy of government subsidy. Parties, campaigns, films, and newspapers in many European countries are subsidized according to this rationale.¹⁸⁷

In the United States, the existence of a public forum is not explicitly recognized as a public good that merits government subsidy.¹⁸⁸ This is not intended to suggest that political activities are bad, or that religious activists should refrain from engaging in political activities. However, since religious activities lack substance-subsidy justifications, the I.R.C. provision should be construed narrowly so as not to include political activities taking place within religious NPOs. Under current law, campaign

187. This aligns well with the perception of legal speech under a democratic republican political theory. See generally C. Edwin Baker, *The Media that Citizens Need*, 147 U. PA. L. REV. 317, 332–33, 365–73 (1998).

188. However, one may wonder why the IRS's scrutiny is focused mainly on religious NPOs engaged in partisan political activity. For example, many works of art tend to be political and many art venues that are recognized as NPOs tend to show political exhibitions that often have a clear political bias toward a specific agenda, candidate, or party. Furthermore, art is typically recognized as a desirable activity because it is a form of public-sphere expression that challenges political conventions and social norms. If, in the case of art, political expression is a public good that merits subsidy, maybe policymakers should extend charitable relief or other subsidies to different forms of public sphere political expressions—for example, church-related political activities and campaign contributions. See Johnny Rex Buckles, *Not Even a Peep? The Regulation of Political Campaign Activity by Charities Through Federal Tax Law*, 75 U. CIN. L. REV. 1071, 1095–97 (2007); Levmore, *supra* note 8, at 391–404 (discussing a provision in the tax code that allows taxpayers to allocate some of their taxes to a fund for presidential campaigns relieving candidates running for office from being dependent on large donors).

contributions and other forms of political expression do not qualify as charitable relief-worthy public goods. Given this status quo, it seems odd that charitable contribution to churches or other NPOs engaged in political campaigns would qualify for charitable relief. Setting aside questions of selective enforcement, it seems that under the dual subsidy analysis, the IRS was right and its critics were wrong. Taxpayers engaging in partisan political activities should subsidize them with their after-tax money rather than channel funds toward those activities through NPOs.

CONCLUSION

Using the example of charitable relief, this Article questions the proper role of efficiency claims in legitimizing rules and decisions within a democratic regime. Indeed, digging into the core justifications of charitable relief reveals that many of the canonical explanations are inconsistent with fundamental aspects of democratic theory. This may be only the tip of the iceberg, however. Many practices that benefit from charitable relief currently go unchallenged—for example, corporate philanthropy—and should be reconsidered and restructured. Doing so may be timely; recent law and economics scholarship has been increasingly emphasizing the growing normative importance of market-emulating, preferences-aggregation models and other nondemocratic methods of decision making.¹⁸⁹

The analytical framework used in this Article touches upon the broader debate of whether the polity's will should be determined through a majoritarian one-person, one-vote mechanism or through a preferences-aggregation process. This debate is not in any way new; it can be traced to the early days of Western civilization. Western democratic theory sprung out of the Athenian one-person, one-vote decision-making model. In contrast, ancient Spartan decision making required individuals to assemble and vote via shouting. This ancient way of determining the polity's will may seem primitive, but it entailed an interesting insight—every Spartan had the option to decide which decision to support *and* how loudly to support it. Hence, assuming no great variation in the capacity to produce high decibels, voting through shouting accounted for not only how many people supported the decision but also how important it was to them.

Using charitable contributions as an example, this Article explains how voting through anonymous, one-for-one ballots and voting by indicating preferences could coherently coexist. I believe that this type of inquiry is necessary, more than ever, to open a transparent debate about the impact of these quiet changes to the role of majority decision making in the context of modern legal theory. The way in which the dual subsidy theory reconciles the substance and process attributes of charitable relief provides a good example for how the frictions between the competing sets of democratic-majoritarian and efficiency values should be addressed.

189. *E.g.*, Cass R. Sunstein, *Group Judgments: Statistical Means, Deliberation, and Information Markets*, 80 N.Y.U. L. REV. 962 (2005) (calling for de-emphasizing the role of the democratic deliberation process and greater reliance on information markets to make factual inquiries).

