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Curbing (or not) Foreign Influence on U.S. Politics and Policies Through the Federal Taxation of Charities

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CURBING (OR NOT) FOREIGN INFLUENCE ON U.S. POLITICS AND POLICIES THROUGH THE FEDERAL TAXATION OF CHARITIES

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ABSTRACT

The 2016 presidential election spawned journalistic accounts igniting great concern across the political spectrum that foreign actors had been interfering with America's democracy. Foreign engagement with politically active nonprofit organizations has contributed to the perceived problem. Although tax-exempt charitable organizations described in section 501(c)(3) of the Internal Revenue Code (the "Code") are limited in how they can influence the political process, a close inspection of the tax laws governing charities reveals that a foreign actor can influence the political process in the United States through donations to, or other interactions with, a U.S. charitable entity in a number of ways. These methods include financially supporting an organization that already advances a mission aligned with the foreign actor's interests, shaping the mission of an existing organization so that it better aligns with the foreign actor's interests, funding new tax-exempt entities that will operate to achieve some purpose aligned with the foreign actor's interests, exploiting the connections that an existing organization has with policymakers, and creating supporting organizations that engage in (limited) lobbying or (virtually unlimited) attempts to influence executive and administrative action. From the fundamental requirements for qualifying an organization for federal income tax exemption to complex excise tax provisions affecting charities and their managers, the Code imposes norms of fiduciary behavior on the managers of charitable organizations. Precisely how the discharge of fiduciary duties is

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affected by the tax system varies with the type of tax-exempt organization in question. This Article will explore the issue of how effectively the tax system's regulation of fiduciary behavior prevents the possible exploitation of charities by foreign actors for purposes of influencing U.S. democratic processes and policies and will propose plausible legal reforms.

INTRODUCTION

Overwhelming evidence establishes that the Russian government attempted to interfere with the 2016 U.S. presidential election.[1] Further, Russia and China routinely seek to meddle with U.S. politics and policy.[2] Indeed, in a joint statement issued in October 2018, the Office of the Director of National Intelligence, the Department of Justice, the Federal Bureau of Investigation, and the Department of Homeland Security warned of "ongoing campaigns by Russia, China and other foreign actors, including Iran, to undermine confidence in democratic institutions and influence public sentiment and government policies."[3]

Questions loom as to the extent and efficacy of this foreign meddling in our country's democratic processes. The most publicized query, whether members of the victorious campaign of President Donald J. Trump conspired with Russia to sway the election, prompted the appointment of a special counsel, Robert S. Mueller, III, to investigate the matter.[4] But the special counsel's inquiry was only the tip of the iceberg of questions that should be asked about foreign interference in our democracy.

Journalistic coverage of the 2016 election and relevant events preceding it indicate that foreign actors have sought, or in some cases were speculated to have sought, to influence U.S. democratic processes and policy formulation though their interactions with domestic nonprofit organizations. One

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1. *See, e.g.*, *2016 Presidential Campaign Hacking Fast Facts*, CNN (Oct. 31, 2019, 1:10 PM), https://www.cnn.com/2016/12/26/us/2016-presidential-campaign-hacking-fast-facts/index.html; Scott Shane & Mark Mazzetti, *The Plot to Subvert an Election: Unraveling the Russia Story So Far*, N.Y. TIMES (Sept. 20, 2018), https://www.nytimes.com/interactive/2018/09/20/us/politics/russia-interference-election-trump-clinton.html.

2. *See, e.g.*, Paul. D. Shinkman, *How China, Russia Interfere in U.S. Elections*, U.S. NEWS & WORLD REP. (Nov. 6, 2018, 6:00 AM), https://www.usnews.com/news/national-news/articles/2018-11-06/how-china-russia-interfere-in-us-affairs.

3. Press Release, Office of the Dir. of Nat'l Intelligence, Joint Statement from the ODNI, DOJ, FBI and DHS: Combating Foreign Influence in U.S. Elections (Oct. 19, 2018), https://www.dni.gov/index.php/newsroom/press-releases/item/1915-joint-statement-from-the-odni-doj-fbi-and-dhs-combating-foreign-influence-in-u-s-elections [hereinafter Joint Statement].

4. *See* Rebecca R. Ruiz & Mark Landler, *Special Counsel Will Investigate Russia Influence*, N.Y. TIMES, May 18, 2017, at A1. No conspiracy was ultimately established by Mueller. *See* ROBERT S. MUELLER, U.S. DEP'T OF JUSTICE, REPORT ON THE INVESTIGATION INTO RUSSIAN INTERFERENCE IN THE 2016 PRESIDENTIAL ELECTION 9 (2019), https://www.justice.gov/storage/report.pdf.

example is the infiltration of the National Rifle Association ("NRA") by a Russian citizen angling to enhance ties between the NRA and Russian officials.[5] Another example, which an official investigation apparently has failed to verify, is the conjectured link between government policymaking and large donors, including foreign donors, to the Clinton Foundation while Hillary Rodham Clinton served as Secretary of State.[6]

Even before the 2016 election cycle, evidence was mounting that foreign governments for some time have been transferring large sums to prominent nonprofit research institutions to influence American public policy. *The New York Times* reported in 2014 that over a dozen domestic research organizations had received "a minimum of $92 million in contributions or commitments from overseas government interests over the last four years."[7] The recipients reportedly pressured "United States government officials to adopt policies that often reflect the donors' priorities."[8] According to the *Times*, foreign government officials characterize their relationships with these nonprofits as "pivotal to winning influence on the cluttered Washington stage."[9]

The engagement of nonprofit organizations in the political process generally and the potential exploitation of the nonprofit sector for political purposes specifically have generated vast academic commentary.[10] Numerous

5. *See* Rosalind S. Helderman, Tom Hamburger & Michelle Ye Hee Lee, *Russian Agent's Guilty Plea Intensifies Spotlight on Relationship with NRA*, WASH. POST (Dec. 13, 2018, 7:04 PM), https://www.washingtonpost.com/politics/russian-agents-guilty-plea-intensifies-spotlight-on-relationship-with-nra/2018/12/13/e6569a00-fe26-11e8-862a-b6a6f3ce8199_story.html; *see also* Norman I. Silber, *Foreign Corruption of the Political Process Through Social Welfare Organizations*, 114 NW. U. L. REV. ONLINE 105 (2019) (discussing speculation over whether the NRA used foreign donations to support political campaigns).

6. *See, e.g.*, Stephen Braun & Eileen Sullivan, *Many Donors to Clinton Foundation Met with Her at State*, AP NEWS (Aug. 23, 2016), https://apnews.com/82df550e1ec646098b434f7d5771f625; Matt Zapotosky & Devlin Barrett, *Clinton Charity Probed Again*, WASH. POST, Jan. 6, 2018, at A1. As this Article was nearing publication, press reports indicated that the U.S. Department of Justice had not found any wrongdoing by the Clinton Foundation. *See, e.g.*, Devlin Barrett & Matt Zapotosky, *Justice Dept. Winds Down Clinton-Related Inquiry Once Championed by Trump. It Found Nothing of Consequence.*, WASH. POST (Jan. 9, 2020, 5:56 PM), https://www.washingtonpost.com/national-security/justice-dept-winds-down-clinton-related-inquiry-once-championed-by-trump-it-found-nothing-of-consequence/2020/01/09/ca83932e-32f9-11ea-a053-dc6d944ba776_story.html.

7. Eric Lipton, Brooke Williams & Nicholas Confessore, *Foreign Powers Buy Influence at Think Tanks: Financing of Research Often Isn't Disclosed*, N.Y. TIMES, Sept. 7, 2014, at A1.

8. *Id.*

9. *Id.*

10. *See generally* Erik J. Ablin, *The Price of Not Rendering to Caesar: Restrictions on Church Participation in Political Campaigns*, 13 NOTRE DAME J.L. ETHICS & PUB. POL'Y 541 (1999); Samuel D. Brunson, *Dear IRS, It Is Time to Enforce the Campaigning Prohibition. Even Against Churches*, 87 U. COLO. L. REV. 143 (2016); Samuel D. Brunson, *Reigning in Charities: Using an Intermediate Penalty to Enforce the Campaign Prohibition*, 8 PITT. TAX REV. 125 (2011); Johnny Rex Buckles, *Does the Constitutional Norm of Separation of Church and State Justify the Denial of Tax Exemption to Churches that Engage in Partisan Political Speech?*, 84 IND. L. J. 447 (2009)

[hereinafter Buckles, *Church and State*]; Johnny Rex Buckles, *Is the Ban on Participation in Political Campaigns by Charities Essential to Their Vitality and Democracy? A Reply to Professor Tobin*, 42 U. RICH. L. REV. 1057 (2008) [hereinafter Buckles, *A Reply*]; 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 (2007) [hereinafter Buckles, *Not Even a Peep?*]; Wilfred R. Caron & Deirdre Dessingue, *I.R.C. § 501(c)(3): Practical and Constitutional Implications of "Political" Activity Restrictions*, 2 J.L. & POL. 169 (1985); Anne Berrill Carroll, *Religion, Politics, and the IRS: Defining the Limits of Tax Law Controls on Political Expression by Churches*, 76 MARQ. L. REV. 217 (1992); Laura Brown Chisolm, *Politics and Charity: A Proposal for Peaceful Coexistence*, 58 GEO. WASH. L. REV. 308 (1990); Roger Colinvaux, *The Political Speech of Charities in the Face of* Citizens United*: A Defense of Prohibition*, 62 CASE W. RES. L. REV. 685 (2012); Joel E. Davidson, *Religion in Politics and the Income Tax Exemption*, 42 FORDHAM L. REV. 397 (1973); Deirdre Dessingue, *Prohibition in Search of a Rationale: What the Tax Code Prohibits; Why; to What End?*, 42 B.C. L. REV. 903 (2001); Alan L. Feld, *Rendering unto Caesar or Electioneering for Caesar? Loss of Church Tax Exemption for Participation in Electoral Politics*, 42 B.C. L. REV. 931 (2001); Edward McGlynn Gaffney, Jr., *On Not Rendering to Caesar: The Unconstitutionality of Tax Regulation of Activities of Religious Organizations Relating to Politics*, 40 DEPAUL L. REV. 1 (1990); Brian Galle, *The LDS Church, Proposition 8, and the Federal Law of Charities*, 103 NW. U. L. REV. COLLOQUY 370 (2009); Miriam Galston, *Lobbying and the Public Interest: Rethinking the Internal Revenue Code's Treatment of Legislative Activities*, 71 TEX. L. REV. 1269 (1993); Richard W. Garnett, *A Quiet Faith? Taxes, Politics, and the Privatization of Religion*, 42 B.C. L. REV. 771 (2001); Michael Hatfield, *Ignore the Rumors—Campaigning from the Pulpit Is Okay: Thinking Past the Symbolism of Section 501(c)(3)*, 20 NOTRE DAME J.L. ETHICS & PUB. POL'Y 125 (2006); 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 (2001); Chris Kemmitt, *RFRA, Churches and the IRS: Reconsidering the Legal Boundaries of Church Activity in the Political Sphere*, 43 HARV. J. ON LEGIS. 145 (2006); Randy Lee, *When a King Speaks of God; When God Speaks to a King: Faith, Politics, Tax Exempt Status, and the Constitution in the Clinton Administration*, 63 L. & CONTEMP. PROBS. 391 (2000); Benjamin M. Leff, *"Sit Down and Count the Cost": A Framework for Constitutionally Enforcing the 501(c)(3) Campaign Intervention Ban*, 28 VA. TAX REV. 673 (2009); Lloyd Hitoshi Mayer, *Charities and Lobbying: Institutional Rights in the Wake of* Citizens United, 10 ELECTION L.J. 407 (2011); Lloyd Hitoshi Mayer, *Grasping Smoke: Enforcing the Ban on Political Activity by Charities*, 6 FIRST AMEND. L. REV. 1 (2007); Lloyd Hitoshi Mayer, *Politics at the Pulpit: Tax Benefits, Substantial Burdens, and Institutional Free Exercise*, 89 B.U. L. REV. 1137 (2009); Ann M. Murphy, *Campaign Signs and the Collection Plate—Never the Twain Shall Meet?*, 1 PITT. TAX REV. 35 (2003); 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); Adam Parachin, *Reforming the Regulation of Political Advocacy by Charities: From Charity Under Siege to Charity Under Rescue?*, 91 CHI.-KENT L. REV. 1047 (2016); Judy Ann Rosenblum, *Religion and Political Campaigns: A Proposal to Revise Section 501(c)(3) of the Internal Revenue Code*, 49 FORDHAM L. REV. 536 (1981); Allan J. Samansky, *Tax Consequences When Churches Participate in Political Campaigns*, 5 GEO. J.L. & PUB. POL'Y 145 (2007); Donald B. Tobin, *Political Campaigning by Churches and Charities: Hazardous for 501(c)(3)s, Dangerous for Democracy*, 95 GEO. L.J. 1313 (2007); Ellis M. West, *The Free Exercise Clause and the Internal Revenue Code's Restrictions on the Political Activity of Tax-Exempt Organizations*, 21 WAKE FOREST L. REV. 395 (1986); Joseph S. Klapach, Note, *Thou Shalt not Politic: A Principled Approach to Section 501(c)(3)'s Prohibition of Political Campaign Activity*, 84 CORNELL L. REV. 504 (1999). For analysis of the distinction between political purposes and charitable purpose under the common law, see Adam Parachin, *Charity, Politics and Neutrality*, 18 CHARITY L. & PRAC. REV. 23 (2015).

scholars have defended[11] or decried[12] express statutory limitations or prohibitions on the legislative and political campaign activities of charitable organizations. Others have examined the law's regulation of the political activity of social welfare organizations described in section 501(c)(4) of the Internal Revenue Code (the "Code").[13] However, the question of whether and how foreign actors can systematically influence the political process in the United States through supporting or otherwise engaging nonprofit organizations and their managers has largely escaped scholarly attention.

The time is ripe to examine this issue. Federal intelligence and law enforcement officials have recently observed that "[f]oreign powers have long sought to exploit America's free and open political system."[14] That foreign actors can manipulate our political system through their dealings with U.S. nonprofit organizations is reason enough to suspect that they will seek to do so. The reported cases suggesting that foreign entities have already tried to utilize domestic nonprofits to achieve their political objectives[15] confirm this reasonable suspicion.

The risk that foreign actors can affect the course of our democracy by exploiting social welfare organizations is easily recognized.[16] Less obvious is the potential that even the heavily "tax-regulated" charitable sector is vulnerable to exploitation by foreign actors with political motivations. The potential exploitation of charities by subversive foreign actors may strike some as a remote risk; after all, charities have long been severely limited in their ability to engage overtly in legislative efforts or to wield influence in electoral politics.[17] Nonetheless, this Article will argue that foreign actors can indeed meaningfully impact our political process through their dealings with charities. This Article will also observe how not just foreign actors, but also domestic actors, can influence the political process through their interactions with charities. Whether this reality is a material problem, and (if so) whether

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11. *See, e.g.*, Colinvaux, *supra* note 10, at 699–707; Tobin, *supra* note 10, at 1319–42.

12. *See, e.g.*, Buckles, *Church and State*, *supra* note 10, at 452–80; Buckles, *A Reply*, *supra* note 10, at 1080–1127; Buckles, *Not Even a Peep?*, *supra* note 10, at 1078–1107.

13. *See, e.g.*, Ellen P. Aprill, *Regulating the Political Speech of Noncharitable Exempt Organizations After* Citizens United, 10 ELECTION L.J. 363 (2011); Terence Dougherty, *Section 501(c)(4) Advocacy Organizations: Political Candidate-Related and Other Partisan Activities in Furtherance of the Social Welfare*, 36 SEATTLE U. L. REV. 1337 (2013).

14. Joint Statement, *supra* note 3.

15. *See supra* notes 5–9 and accompanying text.

16. An organization is described in section 501(c)(4) if it is "primarily engaged" in promoting the general welfare of the community. *See* Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) (2019). Thus, a social welfare organization described in section 501(c)(4) may participate in political campaigns, as long as conducting such political activity is not its primary activity. *See* Rev. Rul. 81-95, 1981-1 C.B. 332.

17. *See infra* Section I.A.

the tax system can or should try to solve it, are separate questions. This Article will suggest how these questions should be analyzed, and how policymakers should begin to answer them.

Part I of this Article will explain the necessary tax law background for approaching the issues raised by foreign influence over United States democratic processes and policy formation. This Part will examine the fundamental requirements for obtaining and maintaining federal income tax exemption, the tax classification of charitable entities, and the excise taxes imposed on the political activities of charities. Part II of this Article will explain how foreign actors can influence the political process in the United States under current tax law in a variety of ways. This Part will offer eight brief hypothetical case studies to illustrate methods available to foreign donors, including foreign governments, to influence U.S. politics and policy.

In Part III, this Article will discuss the basic norms of fiduciary behavior that govern charity managers. This Part will explain that the general federal income tax exemption requirements, the specific limitations on engaging in political activities, and the overall federal excise tax regime governing charities largely reinforce the basic fiduciary duties to which charity managers are subject under state law.

Building on the analysis of preceding parts, Part IV of this Article will offer two purely descriptive claims, two descriptive-analytical claims, and eight normative-cautionary claims that speak to the complexity of the relevant issues. These claims crystallize a number of issues and provide direction for legislators, Internal Revenue Service ("IRS") agents, judges, and analysts in determining how to respond to the reality of foreign influence on U.S. political processes and policy formulation through foreign support of domestic charities. Part V will briefly conclude.

I. FUNDAMENTAL EXEMPTION REQUIREMENTS AND LIMITATIONS ON PARTICIPATION IN THE POLITICAL PROCESS BY CHARITIES

To discern how foreign actors can interact with domestic charities to influence U.S. political processes and policymaking under current tax law, one must first understand the basic federal scheme for taxing charitable organizations. Section I.A sets forth the fundamental requirements that a charity must satisfy to qualify for federal income tax exemption under section 501(c)(3). Next, Section I.B discusses how federal tax law classifies charitable entities into four major groups. Finally, Section I.C describes how the federal excise tax regime effectively regulates the legislative and political campaign-related activities of tax-exempt charities according to their classification.

A. Fundamental Exemption Requirements

Section 501(a) exempts from federal income taxation organizations described in section 501(c).[18] Section 501(c)(3) describes the following organizations:

> Corporations, and any community chest, fund, or foundation, [1] organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, [2] no part of the net earnings of which inures to the benefit of any private shareholder or individual, [3] no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and [4] which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.[19]

The Treasury regulations interpret the first requirement[20] as imposing an organizational test and an operational test.[21] Under the organizational test, an entity's charter must limit its purposes to one or more exempt purposes (i.e., the purposes described in section 501(c)(3)),[22] and generally must not expressly empower the charity to engage in activities that do not further those exempt purposes.[23] Under the operational test, an entity must "engage[] primarily in activities which accomplish one or more . . . exempt purposes."[24] An entity fails the test "if more than an insubstantial part of its activities is not in furtherance of an exempt purpose."[25] In addition to restating the statutorily-designated exempt purposes, the regulations state that the term "*charitable*" in section 501(c)(3) retains "its generally accepted legal sense,"[26] and is not "limited by the separate enumeration in section 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of *charity* as developed by judicial decisions."[27]

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18. I.R.C. § 501(a) (2012).
19. *Id.* § 501(c)(3).
20. That is, the requirement immediately following "[1]" in the quoted excerpt.
21. *See* Treas. Reg. § 1.501(c)(3)-1(a) (2019).
22. *See id.* § 1.501(c)(3)-1(b)(1)(i)(A).
23. *See id.* § 1.501(c)(3)-1(b)(1)(i)(B).
24. *Id.* § 1.501(c)(3)-1(c)(1).
25. *Id.* In addition, the organization must not operate so as to violate the other statutory requirements for qualifying under section 501(c)(3). *See id.* § 1.501(c)(3)-1(c)(2)–(3).
26. *Id.* § 1.501(c)(3)-1(d)(2).
27. *Id.*

Further, to satisfy the organizational and operational tests, an organization must serve a public rather than a private interest.[28] This means the entity must "establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests."[29] This language has generated the "private benefit doctrine."[30]

An organization fails the second requirement of section 501(c)(3) if any part of its net earnings "inures to the benefit of any private shareholder or individual."[31] This prohibition against the use of a charity's earnings for private gain, the "private inurement doctrine," differs from the private benefit doctrine in at least two respects.[32] First, it applies only to a "private shareholder or individual," someone "having a personal and private interest in the activities of the organization."[33] Secondly, the prohibition against private inurement literally by statute applies when any portion of "net earnings" of a

28. *See id.* § 1.501(c)(3)-1(d)(1)(ii).

29. *Id.*

30. Applying the private benefit doctrine, the United States Tax Court has held that an organization fails to qualify for income tax exemption when it benefits private interests more than insubstantially. *See, e.g.*, Am. Campaign Acad. v. Comm'r, 92 T.C. 1053, 1067–79 (1989) (holding that an organization that trained people for careers in political campaigning substantially benefited private interests (the Republican party and its candidates) and therefore failed to qualify as a tax-exempt educational organization). In so holding, the Tax Court acknowledged that "[o]ccasional economic benefits flowing to persons as an incidental consequence of an organization pursuing exempt charitable purposes will not generally constitute prohibited private benefits." *Id.* at 1066. However, "[s]econdary benefits which advance a substantial purpose cannot be construed as incidental to the organization's exempt educational purpose." *Id.* at 1078.

The IRS deems a private benefit "incidental" only if it is incidental both quantitatively and qualitatively. *See, e.g.*, I.R.S. Gen. Couns. Mem. 37,789 (Dec. 18, 1978). According to the IRS, a private benefit is quantitatively incidental only if it is not substantial in view of the activity's overall public benefit. *See id.* A benefit is qualitatively incidental only if the benefit is "a necessary concomitant of the activity" benefitting the public (i.e., the only way to benefit the public is to benefit certain private individuals as well). *Id.* *See generally* BRUCE R. HOPKINS, THE LAW OF TAX-EXEMPT ORGANIZATIONS 460–62 (7th ed. 1998) (discussing the private benefit doctrine and observing that the doctrine is distinct from—yet to some extent subsumes—the private inurement doctrine).

31. I.R.C. § 501(c)(3) (2012); Treas. Reg. § 1.501(c)(3)-1(c)(2).

32. *See generally* HOPKINS, *supra* note 30, at 427–60 (discussing the private inurement doctrine).

33. Treas. Reg. § 1.501(a)-1(c). Under case law, a person generally has a private, personal interest in the entity only if she can exert control over its operations. *Compare* United Cancer Council, Inc. v. Comm'r, 165 F.3d 1173, 1178–79 (7th Cir. 1999) (finding no private inurement when a professional fundraising firm that dominated a charitable entity could not formally control it), *with* Variety Club Tent No. 6 Charities, Inc. v. Comm'r, 74 T.C.M. (CCH) 1485, 1493 (1997) (finding that a person had the requisite private interest in a charity when he had a significant voice in its operations and formal and informal control over much of its income).

charitable organization inures to the benefit of an insider—with no de minimis exception.[34] By contrast, conferring "incidental" private benefit is tolerated under the private benefit doctrine.[35]

Under the third requirement of section 501(c)(3), no "substantial part" of a charitable organization's activities may constitute "carrying on propaganda, or otherwise attempting, to influence legislation."[36] Determining whether lobbying constitutes a "substantial part" of an entity's activities is hardly an exact science.[37] A number of charities can avail themselves of a more precise lobbying regime by electing to be governed by section 501(h). A charity that so elects is treated as not having engaged in excessive legislative activities as long as its expenditures properly allocable to lobbying (including direct communications with a legislative body and grass roots lobbying) do not exceed statutory limits.[38] Public charities (other than churches, church conventions and associations, and their integrated auxiliaries) are eligible to make the election.[39] Private foundations are not eligible for the election.[40]

Under the fourth requirement for federal income tax exemption, a charity must "not participate in, or intervene in . . . any political campaign on behalf of (or in opposition to) any candidate for public office."[41] The statutory prohibition of participation in political campaigns is absolute; the charity is prohibited from saying or doing anything in support of (or in opposition to)

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

35. *See* I.R.S. Gen. Couns. Mem. 37,789 (Dec. 18, 1978).

36. I.R.C. § 501(c)(3). Commentary on the limitation on legislative activities is vast. *See, e.g.*, Chisolm, *supra* note 10, at 313 n.24 (citing numerous sources).

37. Most courts consider not only the amount of money expended directly on lobbying, but also other factors (such as the time spent on lobbying, the nature and extent of the lobbying activities, the overall objectives of the organization, and the organization's influence over the legislative process). *See, e.g.*, Christian Echoes Nat'l Ministry, Inc. v. United States, 470 F.2d 849, 855–56 (10th Cir. 1972); Kuper v. Comm'r, 332 F.2d 562, 562–63 (3d Cir. 1964); League of Women Voters v. United States, 180 F. Supp. 379, 383 (Cl. Ct. 1960).

38. *See* I.R.C. § 501(h)(1).

39. *See id.* § 501(h)(4)–(5). For the distinction between a private foundation and other charities, see *infra* Section I.B.

40. *See* I.R.C. § 501(h)(4) (omitting private foundations from the list of charitable organizations eligible for the election).

41. *Id.* § 501(c)(3).

a candidate running for office. The absolute statutory ban on political campaigning has been understood as such by courts,[42] the IRS,[43] and Congress.[44]

Two other requirements an organization must satisfy under section 501(c)(3) are not patently required by the statutory text. In *Bob Jones University v. United States*,[45] the United States Supreme Court opined that an organization qualifies for federal income tax exemption by virtue of section 501(c)(3) only if it does not have a purpose that (1) is illegal or (2) violates "established public policy."[46] The Court reasoned that an organization described in section 501(c)(3) must comply with common law concepts of charity.[47] According to the Court, Congress desired to promote "charitable" organizations because they serve a salutary public purpose.[48] Consistent with the common law, the *Bob Jones* Court concluded that "an institution seeking tax-exempt status must serve a public purpose and not be contrary to established public policy."[49] Thus, a charity is described in section 501(c)(3) only if it survives the legality test and the public policy doctrine.

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42. *See, e.g.*, Ass'n of the Bar of N.Y. v. Comm'r of Internal Revenue, 858 F.2d 876, 881 (2d Cir. 1988); United States v. Dykema, 666 F.2d 1096, 1101 (7th Cir. 1981).

43. *See, e.g.*, I.R.S. Tech. Adv. Mem. 1999-07-021, at 14 (May 20, 1998) ("The prohibition against participation or intervention in a political campaign is absolute."); I.R.S. Gen. Couns. Mem. 39,441 (Nov. 7, 1985). The IRS has at times determined not to revoke exemption for political activities that it determines (purely in its discretion) do not merit such action. *See, e.g.*, Political Expenditures by Section 501(c)(3) Organizations, 60 Fed. Reg. 62,209, 62,209 (Dec. 5, 1995) (codified at 26 C.F.R. pts. 1, 53, 301); I.R.S. Field Serv. Mem. (Sep. 21, 1993), 1993 FSA LEXIS 65.

44. *See, e.g.*, H.R. REP. NO. 91-413, pt. 1, at 32 (1969); S. REP. NO. 91-552, at 47 (1969) (stating that "no degree of support for an individual's candidacy for public office is permitted").

45. 461 U.S. 574 (1983).

46. *Id.* at 591, 595–96 (holding that two schools maintaining racially discriminatory policies as to students violated established public policy).

47. *See id.* at 586, 588–89.

48. *See id.* at 587–88 ("Congress sought to provide tax benefits to charitable organizations, to encourage the development of private institutions that serve a useful public purpose or supplement or take the place of public institutions of the same kind.").

49. *Id.* at 586. For commentary, see, for example, David L. Anderson, *Tax Exempt Private Schools Which Discriminate on the Basis of Race: A Proposed Revenue Procedure*, 55 NOTRE DAME LAW. 356 (1980); Bruce N. Bagni, *Discrimination in the Name of the Lord: A Critical Evaluation of Discrimination by Religious Organizations*, 79 COLUM. L. REV. 1514 (1979); David A. Brennen, *Charities and the Constitution: Evaluating the Role of Constitutional Principles in Determining the Scope of Tax Law's Public Policy Limitation for Charities*, 5 FLA. TAX REV. 779 (2002); David A. Brennen, *The Power of the Treasury: Racial Discrimination, Public Policy, and "Charity" in Contemporary Society*, 33 U.C. DAVIS L. REV. 389 (2000); Johnny Rex Buckles, Bob Jones University v. United States, *in* LAW & RELIGION: CASES IN CONTEXT (Leslie C. Griffin ed., 2010); Johnny Rex Buckles, *Do Law Schools Forfeit Federal Income Tax Exemption When They Deny Military Recruiters Full Access to Career Services Programs? The Hypothetical Case of* Yale University v. Commissioner, 41 ARIZ. ST. L.J. 1 (2009) [hereinafter Buckles, *Law Schools*]; Johnny Rex Buckles, *Reforming the Public Policy Doctrine*, 53 U. KAN. L. REV. 397 (2005) [hereinafter Buckles, *Reforming*]; Johnny Rex Buckles, *The Sexual Integrity of Religious Schools and Tax Exemption*, 40 HARV. J. L. & PUB. POL'Y 255 (2017) [hereinafter Buckles, *Religious Schools*]; John D. Colombo, *Why Is Harvard Tax-Exempt? (And Other Mysteries of Tax Exemption for Private Educational Institutions*), 35 ARIZ. L. REV. 841, 853–55 (1993); Wilfred F. Drake, *Tax Status of Private Segregated Schools: The New Revenue Procedure*, 20 WM. & MARY L. REV. 463 (1979);

B. Classification of Charitable Entities

The federal tax regime regulates charities according to a fairly stable classification system. A basic grasp of this classification system is essential to understand how the Code regulates various types of charities.

Section 509 classifies charitable entities according to their sources of support, their affiliation with other charitable organizations, and (to a limited degree) the nature of their operations.[50] A charity that is not described in one

Miriam Galston, *Public Policy Constraints on Charitable Organizations*, 3 VA. TAX REV. 291 (1984); Charles O. Galvin & Neal Devins, *A Tax Policy Analysis of* Bob Jones University v. United States, 36 VAND. L. REV. 1353 (1983); Olatunde Johnson, *The Story of* Bob Jones University v. United States: *Race, Religion, and Congress' Extraordinary Acquiescence*, *in* STATUTORY INTERPRETATION STORIES 127 (William N. Eskridge, Jr., Philip P. Frickey & Elizabeth Garret eds., 2011); Lindsay Kreppel, *Will the Catholic Church's Tax Exempt Status Be Threatened Under the Public Policy Limitation of § 501(c)(3) if Same-Sex Marriage Becomes Public Policy?*, 16 DUQ. BUS. L.J. 241 (2014); Jerome Kurtz, *Difficult Definitional Problems in Tax Administration: Religion and Race*, 23 CATH. LAW. 301 (1978); Douglas Laycock, Observation, *Tax Exemptions for Racially Discriminatory Religious Schools*, 60 TEX. L. REV. 259 (1982); Paul S. Milich, *Racially Discriminatory Schools and the IRS*, 33 TAX LAW. 571 (1980); Nicholas A. Mirkay, *Globalism, Public Policy, and Tax-Exempt Status: Are U.S. Charities Adrift at Sea?*, 91 N.C. L. REV. 851 (2013); Nicholas A. Mirkay, *Is It "Charitable" to Discriminate?: The Necessary Transformation of Section 501(c)(3) into the Gold Standard for Charities*, 2007 WIS. L. REV. 45 (2007); Amy Moore, *Rife with Latent Power: Exploring the Reach of the IRS to Determine Tax-Exempt Status According to Public Policy Rationale in an Era of Judicial Deference*, 56 S. TEX. L. REV. 117 (2014); Thomas Stephen Neuberger & Thomas C. Crumplar, *Tax Exempt Religious Schools Under Attack: Conflicting Goals of Religious Freedom and Racial Integration*, 48 FORDHAM L. REV. 229 (1979); Karla W. Simon, *Applying the* Bob Jones *Public-Policy Test in Light of TWR and U.S. Jaycees*, 62 J. TAX'N 166 (1985); Paul E. Truesch, Bob Jones-*Where Now?*, 62 TAXES 43 (1984); David Asaki, Michael A. Jacobs & Sharon Y. Scott, Comment, *Racial Segregation and the Tax-Exempt Status of Private Educational and Religious Institutions*, 25 HOW. L.J. 545 (1982); William Chamblee, Note, *IRS Acted Within Its Authority in Determining that Racially Discriminatory Non-Profit Private Schools Are Not "Charitable" Institutions Entitled to Tax-Exempt Status*, 15 ST. MARY'S L.J. 461 (1984); Robert J. Christians, Note, *The IRS, Discrimination, and Religious Schools: Does the Revised Proposed Revenue Procedure Exact Too High a Price?*, 56 NOTRE DAME LAW. 141 (1980); Colleen K. Connell, Comment, *The Tax-Exempt Status of Sectarian Educational Institutions that Discriminate on the Basis of Race*, 65 IOWA L. REV. 258 (1979); William A. Drennan, Note, Bob Jones University v. United States: *For Whom Will the Bell Toll?*, 29 ST. LOUIS U. L.J. 561 (1985); Daniel L. Johnson, Jr., Note, *Federal Taxation-Bob* Jones University v. United States: *Segregated Sectarian Education and IRC Section 501(c)(3)*, 62 N.C. L. REV. 1038 (1984); R. Tyrone Kee, Note, *The I.R.S. Fights Racial Discrimination in Higher Education: No Tax Exemption for Religious Institutions That Discriminate Because of Race*. "Bob Jones University," 10 S.U.L. REV. 291 (1984); Joe W. Miller, Note, *Applying a Public Benefit Requirement to Tax-Exempt Organizations*, 49 MO. L. REV. 353 (1984); Richard S. Myers, Note, *The Internal Revenue Service's Treatment of Religiously Motivated Racial Discrimination by Tax Exempt Organizations*, 54 NOTRE DAME LAW. 925 (1979); Ricki J. Schweizer, Comment, *Federal Taxation-Exempt Organizations—Constitutional Law—First Amendment—Right to Free Exercise of Religion*—Bob Jones University v. United States, 30 N.Y.L. SCH. L. REV. 825 (1985); Sherri L. Thornton, Note, *Taxation in Black and White: The Disallowance of Tax-Exempt Status to Discriminatory Private Schools* Bob Jones University v. United States, 27 HOW. L.J. 1769 (1984); Note, *The Judicial Role in Attacking Racial Discrimination in Tax-Exempt Private Schools*, 93 HARV. L. REV. 378 (1979).

50. I.R.C. § 509(a) (2012).

of the subsections of section 509(a) is classified as a private foundation.[51] The following discussion succinctly describes the major types of charities.[52]

1. Unaffiliated Public Charities

One may categorize a tax-exempt charity described in section 509(a)(1) or 509(a)(2) as an "unaffiliated public charity."[53] Traditional public charities—churches, primary and secondary schools, colleges, universities, hospitals, and certain medical research organizations affiliated with hospitals—fall into this category.[54] They derive their nonprivate foundation status from their normal charitable operations.[55]

Other entities are unaffiliated public charities because of their sources of funding. One type includes any organization that normally receives a substantial portion of its total support—exclusive of income received in performing its tax-exempt function—from a governmental unit or from contributions broadly (and directly or indirectly) from the general public.[56] Another type includes any charity that does not normally receive more than one third of its total support from unrelated business activities and investments, and normally receives more than one third of its total support from gifts, grants, membership fees, and income from performing an exempt function.[57]

2. Supporting Organizations

Another type of charity classified as other than a private foundation is a supporting organization ("SO").[58] An SO maintains a subsidiary/parent or

51. *See id.* (opening sentence).

52. The classification system and discussion appearing herein is substantially similar to that set forth in several of my prior articles. *See, e.g.*, Johnny Rex Buckles, *Fiduciary Assumptions Underlying the Federal Excise Taxation of Compensation Paid by Charities*, 45 REAL PROP. TR. & EST. L.J. 53, 58–62 (2010); Johnny Rex Buckles, *Should the Private Foundation Excise Tax on Failure to Distribute Income Generally Apply to "Private Foundation Substitutes"? Evaluating the Taxation of Various Models of Charitable Entities*, 44 NEW ENG. L. REV. 493, 498–503 (2010); Johnny Rex Buckles, *The Federalization of the Duty of Loyalty Governing Charity Fiduciaries Under United States Tax Law*, 99 KY. L.J. 645, 662–64 (2011) [hereinafter Buckles, *Duty of Loyalty*].

53. An entity described in paragraph (1) or (2) of section 509(a) may have a formal affiliation with another charity. However, any such affiliation is not essential to the entity's classification as other than a private foundation. *See generally* I.R.C. § 509(a). Hence, the term "unaffiliated public charity" in this Article refers to any organization described in section 509(a)(1) or (2), regardless of its relationship to another charity.

54. *See* I.R.C. §§ 170(b)(1)(A)(i)–(iii), 509(a)(1).

55. *See id.*

56. *Id.* §§ 170(b)(1)(A)(vi), 509(a)(1); Treas. Reg. §1.170A-9(e) (2019) (setting forth two alternative tests for qualifying as a publicly supported organization).

57. *See* I.R.C. § 509(a)(2). For these purposes, qualifying support does not include receipts from certain insiders of the charity or from non-publicly supported charities. *See id.* § 509(a)(2)(A).

58. *See id.* § 509(a)(3); Treas. Reg. § 1.509(a)-4(g)(1)(i).

brother/sister relationship with another charity.[59] An SO must satisfy three technical requirements.[60] First, the SO must be organized and operated solely "for the benefit of, to perform the functions of, or to carry out the purposes of" a section 509(a)(1) or 509(a)(2) entity ("supported organization").[61] Second, the SO must satisfy one of three alternative statutory requirements ensuring that the supported organization controls the SO, or that the two entities share common supervision or complementary operations.[62] These requirements underpin the classification of an SO as a "Type I," "Type II," or "Type III" SO.[63] Finally, certain insiders, including large donors and their family members, must not control the SO.[64]

3. *Private Foundations*

A tax-exempt entity described in section 501(c)(3) that is neither an SO nor an unaffiliated public charity is classified as a private foundation.[65] Typically, a single large donor or a small band of donors funds the private foundation.[66]

4. *Donor Advised Funds*

A donor advised fund ("DAF") may properly be conceptualized as forming yet another category of charitable entity. In legal form, a DAF is a component of a charity, not a distinct legal person.[67] However, transactions involving a DAF are subject to special excise tax rules that functionally require analysis of a DAF as though it were a charitable entity for some purposes of law.[68] Subject to narrow exceptions,[69] a DAF is a fund or account that meets four requirements.[70] First, the charity that sponsors the fund must separately identify it "by reference to contributions of a donor or donors."[71] Secondly, the sponsoring charity must own and control the fund.[72] Third, by

59. *See* Treas. Reg. § 1.509(a)-4(g)(1)(i); STAFF OF JOINT COMM. ON TAXATION, 109th CONG., TECHNICAL EXPLANATION OF H.R. 4 331–32 (Comm. Print 2006).

60. *See* I.R.C. § 509(a)(3).

61. *Id.* § 509(a)(3)(A).

62. *Id.* § 509(a)(3)(B); Treas. Reg. § 1.509(a)-4(f)(2)(i)–(ii).

63. *See* Treas. Reg. § 1.509(a)-4(f)(2)(i)–(iii).

64. *See* I.R.C. §§ 509(a)(3)(C), 4946.

65. *See id.* § 509(a).

66. *See* STAFF OF JOINT COMM. ON TAXATION, *supra* note 59, at 335.

67. *See* I.R.C. § 4966(d)(2)(A).

68. *See, e.g.*, *id.* §§ 4966–67.

69. *See id.* § 4966(d)(2)(B)(i)–(ii) (exempting from the definition of a DAF those funds that distribute money only to a single entity and those from which money may be distributed only for certain education-related grants upon the recommendation of a committee appointed by the sponsoring organization).

70. *See id.* § 4966(d)(1)(B), (d)(2)(A).

71. *Id.* § 4966(d)(2)(A)(i).

72. *Id.* § 4966(d)(2)(A)(ii).

reason of her status as a donor, the donor of the fund, or her designee, must have advisory privileges with respect to the distribution or investment of fund assets.[73] Finally, the charity sponsoring the DAF must not be a private foundation.[74]

C. *Excise Taxes on the Political Activities of Charities*

The Code imposes a number of excise taxes that severely constrain the operations of charitable entities. The degree to which these excise taxes effectively regulate charitable activities varies with the type of charity subject to taxation. The Code indirectly regulates two types of political activity by charities through the excise tax system: attempts to influence legislation and engagement in electoral politics. This Section summarizes the relevant taxes on charitable organizations' political activity.

1. *Attempts to Influence Legislation*

In addition to limiting the legislative activities of charities through the general requirements for qualifying for tax exemption, the Code restricts lobbying through an excise tax regime. This Section explains the excise tax regime governing private foundations and that governing other charities.

a. *Private Foundations*

Section 4945 imposes an excise tax on "taxable expenditure[s]" of private foundations, which include any amount paid or incurred "to carry on propaganda, or otherwise to attempt, to influence legislation."[75] These activities mean (1) attempting to influence legislation by trying to affect the opinion of the general public or any segment thereof;[76] and (2) attempting to influence legislation by communicating "with any member or employee of a legislative body, or with any other government official or employee who may participate in" formulating the legislation.[77] However, the following activities do not give rise to excise tax: (1) providing "technical advice or assistance to a governmental body or to a committee or other subdivision thereof in response to a written request by" that body or subdivision;[78] (2) making

73. *See id.* § 4966(d)(2)(A)(iii).
74. *See id.* § 4966(d)(1)(B) (defining "sponsoring organization" to exclude a private foundation). The definitional requirements of a DAF do not imply that a private foundation is prohibited from soliciting funds and holding them in separate accounts. Rather, any such account would simply not meet the definition of a DAF.
75. *Id.* § 4945(d)(1).
76. *Id.* § 4945(e)(1).
77. *Id.* § 4945(e)(2).
78. *Id.*

available the results of nonpartisan analysis, study, or research;[79] and (3) appearing before, or communicating with, "any legislative body with respect to a possible decision" of that "body which might affect the existence of the private foundation, its powers and duties, its tax-exempt status, or the deduction of contributions" to the foundation.[80] A taxable expenditure triggers a tax that is generally imposed both on the private foundation itself,[81] and on any foundation manager (including a board member) who knowingly agreed to the taxable expenditure.[82]

b. Other Charities

Charities other than private foundations are subject to excise taxes for lobbying under either section 4911 or 4912, depending on whether they elected to be subject to section 501(h). Under section 4911(a), an organization which has made the section 501(h) election is subject to an excise tax on its excess lobbying expenditures for the taxable year. The term "excess lobbying expenditures" means the greater of the following:

> (1) the amount by which the lobbying expenditures [i.e., the sum of direct lobbying expenditures and grass roots lobbying expenditures] made by the organization during the taxable year exceed the lobbying nontaxable amount for [the] organization for [that] taxable year, or
>
> (2) the amount by which the grass roots expenditures made by the organization during the taxable year exceed the grass roots nontaxable amount for [the] organization for [that] taxable year.[83]

If an organization eligible to make the section 501(h) election does not do so, and if the organization disqualifies itself from exemption under section 501(c)(3) by making excessive lobbying expenditures, section 4912(a) imposes a tax on the organization's lobbying expenditures.[84] A "'lobbying expenditure' means any amount paid or incurred by the organization in carrying

79. *Id.*

80. *Id.* § 4945(e).

81. *See id.* § 4945(a)(1), (b)(1).

82. *See id.* § 4945(a)(2), (b)(2). A foundation manager is liable for paying the excise tax imposed on management if her participation in the decision to cause the foundation to make the taxable expenditure involves "knowing" that it is a taxable expenditure, unless her consent to the transaction "is not willful and is due to reasonable cause." *Id.* § 4945(a)(2).

83. *Id.* § 4911(b). The "lobbying nontaxable amount" is defined in section 4911(c)(2), and the "grass roots nontaxable amount" is twenty-five percent of the lobbying nontaxable amount. *Id.* § 4911(c)(4). The tax under section 4911 applies only to the organization itself. *See id.* § 4911(a).

84. *See id.* § 4912(a), (c). If the organizational tax is imposed under section 4912(a), section 4912(b) imposes a tax on any manager who agreed to the making of the lobbying expenditure, if the manager knew at the time that the expenditure was likely to disqualify the organization from tax exemption under section 501(c)(3). *Id.* § 4912(b). This tax on management applies unless the manager's agreement to make the expenditure "is not willful and is due to reasonable cause." *Id.*

on propaganda, or otherwise attempting to influence legislation."[85] Thus, the excise tax base is not limited to lobbying expenditures in excess of those that could have been made without sacrificing federal income tax exemption.

2. *Political Campaign-Related Activity*

Federal tax law reinforces the ban on political campaign intervention by tax-exempt charities under Code section 501(c)(3) through excise taxes. This Section discusses the excise taxes governing private foundations and those governing charities generally.

a. *Private Foundations*

The section 4945 private foundation excise tax on "taxable expenditures" also applies to any amount paid or incurred "to influence the outcome of any specific public election, or to carry on, directly or indirectly, any voter registration drive" (except as provided in section 4945(f)).[86] As previously discussed, a taxable expenditure triggers a tax that is generally imposed both on the private foundation itself[87] and on any foundation manager (including a board member) who knowingly agreed to the taxable expenditure.[88] However, if a tax is imposed under section 4955 (discussed in the next Subsection) with respect to any political expenditure, it will not be treated as a taxable expenditure for purposes of section 4945.[89]

b. *Charities Generally*

A charity that violates the prohibition against participation in a political campaign is subject to a special tax under section 4955,[90] in addition to the loss of federal income tax exemption.[91] Section 4955 imposes this tax on a charitable organization's "political expenditure[s]," which are defined to include amounts paid or incurred in engaging in political activities prohibited

85. *Id.* § 4912(d)(1).
86. *Id.* § 4945(d)(2).
87. *See id.* § 4945(a)(1), (b)(1).
88. *See id.* § 4945(a)(2), (b)(2).
89. *Id.* § 4955(e).
90. *See id.* § 4955.
91. There is no statutory authorization for an organization to pay the section 4955 tax in lieu of forfeiting exemption when it violates the ban on participation in a political campaign. However, the IRS may choose to allow an offending organization to maintain its exemption if it pays the section 4955 tax and/or takes other appropriate action to minimize the likelihood of committing future violations. *See supra* note 43.

by section 501(c)(3).[92] A tax is imposed on both the organization[93] and certain of its managers.[94]

II. FOREIGN INFLUENCE ON THE POLITICAL PROCESS THROUGH THE SUPPORT OF U.S. CHARITIES: HYPOTHETICAL CASE STUDIES

The fundamental tax exemption requirements and the excise taxes imposed on certain political expenditures of charities provide some safeguard against the exploitation of charitable organizations by politically motivated foreign actors. For example, the effective ban on electioneering under section 501(c)(3) and the onerous excise tax regime previously summarized foreclose one of the more obvious types of political meddling—supporting charities that intervene in political campaigns to support or oppose a candidate for public office.[95] Nonetheless, an actor, including a foreign actor, can influence the political process in the United States through donations to, or other interaction with, a U.S. charitable entity in a variety of ways.

To illustrate, but by no means exhaust, such strategies, this Article offers several hypothetical case studies featuring the adoption of the following techniques: (1) financially supporting a charitable organization that already advances a mission aligned with the foreign actor's interests but that does not lobby; (2) shaping the mission of an existing organization, which does not lobby, so that it better aligns with the foreign actor's interests through the promise of financial support; (3) funding new, unaffiliated charities that will operate to achieve some purpose aligned with the foreign actor's interests, in part through lobbying; (4) financially supporting an unaffiliated public charity that already advances a mission aligned with the foreign actor's interests,

92. *See* I.R.C. § 4955(d)(1) (stating that a political expenditure generally "means any amount paid or incurred by a section 501(c)(3) organization in any participation in, or intervention in (including the publication or distribution of statements), any political campaign on behalf of (or in opposition to) any candidate for public office"). In addition, political expenditures include other expenses (such as those relating to speeches, travel, fundraising, and surveys) paid or incurred by an organization formed primarily to promote someone's candidacy for public office (or an organization that a candidate effectively controls and is availed of primarily for those purposes). *Id.* § 4955(d)(2).

93. *See id.* § 4955(a)(1) (imposing an entity-level tax of ten percent of the amount of the political expenditure). If the expenditure is not corrected within a specified period of time, the organization must pay an additional tax of 100% of the amount of the political expenditure. *Id.* § 4955(b)(1).

94. *See id.* § 4955(a)(2) (imposing a tax of 2.5% of the amount of the political expenditure on a manager who knowingly agreed to make the expenditure). The tax does not apply if the manager's agreement to make the expenditure "is not willful and is due to reasonable cause." *Id.* If the expenditure is not corrected within a specified period of time, any manager who refused to agree to correct it must pay an additional tax of fifty percent of the amount of the political expenditure. *Id.* § 4955(b)(2). For any one political expenditure, the maximum amount of the tax imposed by section 4955(a)(2) is $5000, and the maximum amount of the tax imposed by section 4955(b)(2) is $10,000. *Id.* § 4955(c)(2).

95. *See supra* Section I.C.2.

in part through lobbying; (5) financially supporting a new or existing SO that already advances a mission aligned with the foreign actor's interests, in part through lobbying; (6) exploiting the connections that an existing charitable organization has with policymakers as a "favor" to a donor; (7) directly contributing to a publicly supported charity that attempts to influence executive action; and (8) directly contributing to an SO that attempts to influence executive action.

Case 1: Supporting an Existing, Favored Charity and Its Mission Without Lobbying

Consider Green Tree Charity ("Green Tree"), formed to educate the American public on the dangers of fossil fuels and the feasibility of developing environmentally friendly alternatives, such as solar and wind power. Green Tree has just received an unconditional gift of $10 million from a Russian oil baron with "ties to the Kremlin." Green Tree uses the money to further its historic mission, and it may now have a greater influence on public opinion concerning the relative merit of clean energy versus fossil fuels. The donor hopes that Green Tree will use its support to shape public opinion in the United States so as to create a socio-political climate more receptive to heightened federal regulation of the U.S. domestic oil and gas industry, thereby conferring a competitive advantage on the Russian oil baron's businesses overseas.

The Code does not check the type of foreign influence illustrated in *Case 1*. Let us first consider the fundamental exemption requirements. Green Tree's general education efforts further an exempt purpose and its historic charitable mission. They do not alone constitute grass roots or direct lobbying activities because, among other reasons, they neither refer to specific legislation nor encourage action on specific legislation.[96] Although it is conceivable that the oil baron's large donation would, under all the facts and circumstances, result in his "insider" status for purposes of the prohibition against private inurement, Green Tree has done nothing with its funds to benefit the donor in any unique way distinct from carrying out plainly charitable operations. Hence, a court would not likely find a violation of the prohibition against private inurement of net earnings. Similarly, insofar as Green Tree is merely using the oil baron's donation to further its charitable mission broadly, any improvement in the donor's financial position attributable to a positive "clean energy" regulatory environment that resulted from Green Tree's educational efforts would surely constitute, at most, a private benefit to the oil baron that is incidental[97] and consistent with Green Tree's exempt status.

96. *See* Treas. Reg. § 56.4911-2(b)(1)(ii), 2(b)(2)(ii) (2019).
97. *See* I.R.S. Gen. Couns. Mem. 37,789 (Dec. 18, 1978). For a discussion of whether private benefit is "incidental," see *supra* note 30.

It is also unlikely that any federal excise tax would apply to Green Tree's use of the donated funds, whether or not Green Tree is a private foundation. For example, if Green Tree is a private foundation, the general education outlays advancing a charitable mission should not constitute "taxable expenditures."[98] Further, even if the donation would render the oil baron a disqualified person with respect to Green Tree,[99] any benefit that he later enjoys from more robust U.S. regulation of the domestic oil and gas industry flows solely from expenditures that directly carry out Green Tree's charitable mission. Hence, this benefit should be deemed innocuously "incidental" under the private foundation self-dealing excise tax rules.[100] Moreover, if Green Tree is not a private foundation, the donation would not give rise to what is conceptually similar to the private foundation self-dealing excise tax, the excess benefit transaction excise tax,[101] because, under the facts of *Case 1*, no "excess benefit transaction" has occurred.[102] Finally, because the general educational activities of Green Tree are not lobbying, excise taxes on certain lobbying expenditures would not apply.[103] In short, the fundamental exemption requirements and the federal excise tax regime do not foreclose the foreign influence on U.S. political processes illustrated in *Case 1*.

Case 2: Influencing a Charity's Mission to Comport with a New, Favored Charitable Mission Without Lobbying

Now consider Amnesty Alliance for All ("AAA"), a global human rights organization that seeks the humane treatment and release of political prisoners around the globe. AAA is contacted by a prospective donor who

98. The expenditure accomplishes a charitable purpose (so it is not a taxable expenditure under section 4945(d)(5)), and it is not an amount paid to influence legislation (so it is not a taxable expenditure under section 4945(d)(1)).

99. A disqualified person of a private foundation includes a "substantial contributor" to the foundation. *See* I.R.C. §§ 4946(a)(1)(A), (a)(2), 507(d)(2).

100. *See* Treas. Reg. § 53.4941(d)-2(f)(2) ("The fact that a disqualified person receives an incidental or tenuous benefit from the use by a foundation of its income or assets will not, by itself, make such use an act of self-dealing."). This special rule is an exception to the general rule that acts of self-dealing between a private foundation and a disqualified person are taxable. *See* I.R.C. § 4941(a)(1)–(2), (b)(1)–(2). Such acts of self-dealing normally include any "transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation." *Id.* § 4941(d)(1)(E).

101. *See* I.R.C. § 4958.

102. *See id.* § 4958(c)(1)(A) (defining "excess benefit transaction" as "any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit"). In *Case 1*, the only "transaction" between the donor and the charity is the donation itself. Because the gift is unconditional, the charity's unilateral use of the gift is not part of the "transaction" with the donor.

103. *See* Treas. Reg. § 56.4911-2(b)(1)(ii), (b)(2)(ii).

believes that AAA should focus its efforts on the humane treatment of political prisoners in Middle Eastern countries. Although AAA has previously sought to impact the humane treatment of political prisoners everywhere, the new focus would limit most of AAA's activities to Iran, Pakistan, and Turkey. Convincing the charity the new focus is justified, the donor contributes $20 million to AAA, and AAA implements the narrower mission. The donor is in fact a Chinese aristocrat and patriot who believes AAA's new focus will lessen international scrutiny of human rights abuses by the Chinese government and thereby relieve China from some measure of pressure from the U.S. government to improve its treatment of Chinese dissidents.

The differences between *Case 1* and *Case 2* are primarily two. First, the donor in *Case 2* has succeeded in narrowing the charitable mission of the charitable donee, rather than merely helping the charity fulfill purposes it has unilaterally determined to advance. Secondly, the donor in *Case 2* has ulterior motives to benefit a foreign government, rather than the private donor herself.

Neither of these two differences triggers a federal income tax or excise tax problem for the charitable donee, however. As discussed below, federal income tax law does not generally impose a historic mission fidelity norm, or even a static charter fidelity norm.[104] It is enough that the organization, at any given time, is advancing a charitable purpose; the organization is free to alter its charter purposes, as long as the new purposes are described in section 501(c)(3). Moreover, a foreign donor, or any donor for that matter, is not prevented by federal tax law from persuading a charity to refocus its operations.

The second difference between *Case 1* and *Case 2* probably presents even less of a problem. In the first place, it is not a private person but another governmental body (China) that the donor hopes will benefit indirectly and remotely from the charitable donee's operations. But even if a foreign government, which is by definition a public entity, can be considered a "private" actor for purposes of the prohibition against private inurement of net earnings and excessive private benefit, there is little legal jeopardy for our hypothetical charity. Because the foreign government has no "insider" status as a large donor, the prohibition against private inurement of net earnings would not apply to it even if it is deemed a private actor.[105] And as to the private benefit doctrine, any benefit received by China in *Case 2* is probably at least as remote and incidental as the benefit to the oil baron in *Case 1*.[106]

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104. For a discussion of these norms, see *infra* Section III.A.3 and notes 142 and 152.

105. Of course, this claim assumes that no other basis for conferring insider status on the foreign government exists.

106. Any time a charity narrows its charitable purposes, it implicitly determines not to directly advance other charitable purposes. Further, in *Case 2*, the new absence of AAA's focus on Asia may simply prompt other human rights organizations to direct more attention to China when they learn that AAA is focusing on Turkey, Iran, and Pakistan.

Case 3: Funding a New, Unaffiliated Charity to Advance a Favored Charitable Mission, in Part Through Lobbying

The first two cases feature a foreign actor's dealings with an existing U.S. charity. But foreign persons need not limit themselves to such interactions. Assume now that a new charity, the Enlightenment Society of the Advanced ("ESA"), has been formed to educate the public about the plausibility of atheism and the virtues of an atheistic worldview in public policy and private life. ESA believes that stamping out official government exemptions from broadly applicable laws for religious objectors will help promote its atheistic worldview. Accordingly, ESA will devote a portion of its resources to lobbying for the repeal of the Religious Freedom Restoration Act of 1993 ("RFRA")[107]—of course, without explicitly stating this goal in its corporate charter. ESA is initially funded by, and is the brainchild of, a wealthy German socialist, "Comrade Conrad," who has publicly extolled communist regimes and desires to influence the American population to be receptive to communist thought. Conrad believes promulgating atheistic ideals and promoting a public climate highly favorable towards atheism will lay a foundation in which communist political philosophy is more likely to thrive. ESA is funded with $100 million of initial capital donated by Conrad and is controlled by a small board consisting of Conrad's associates.

In *Case 3*, the charter purposes of ESA are consistent with the charity advancement norm[108] because they are "educational" and possibly "religious" as well. However, *Case 3* differs from the other cases in several respects. Although there is no private benefit or private inurement issue, in *Case 3* a foreign actor has donated funds to a charity that will directly influence the U.S. political process through lobbying. *Case 3* thus illustrates a difference in kind, not simply in degree, of foreign influence over the U.S. political process. Moreover, the donee is a new charity, not simply an existing one.

These combined differences are likely fatal to ESA's federal income tax exemption if it is unaffiliated with a public charity. Although ESA is free to engage in non-substantial legislative activities under section 501(c)(3), it cannot do so if it is a private foundation. A private foundation's governing instrument must, in relevant part, prohibit it from making a taxable expenditure,[109] which includes amounts paid to influence legislation.[110] With Conrad's domination of ESA's operations from its inception and ESA's dependence on Conrad's donation for operations, Conrad's seed capital donated to ESA would likely not constitute an "unusual grant" to ESA under Treasury

107. 42 U.S.C. §§ 2000bb–2000bb-4 (2012).
108. *See infra* Section III.A.
109. *See* I.R.C. § 508(e)(1)(B) (2012).
110. *See id.* § 4945(d)(1).

regulations,[111] thereby severely calling into question ESA's ability to qualify as a public charity by virtue of its public support. If ESA is a private foundation rather than a public charity, it cannot, without incurring severe excise taxes and jeopardizing its federal income tax exemption, operate as planned.

111. For purposes of applying the tests to determine whether an organization has received sufficiently broad public support in order to avoid private foundation status under section 509(a)(1) and section 170(b)(1)(A)(vi), certain contributions are excluded (i.e., not counted in the calculations of public support and total support). The exclusion "is generally intended to apply to substantial contributions or bequests from disinterested parties" that (1) an organization attracts "the publicly supported nature of the organization," (2) are in an amount that is "unusual or unexpected," and (3) would, on account of size, "adversely affect the status of the organization as" a public charity. Treas. Reg. § 1.170A-9(f)(6)(ii)(A)(1)–(3) (2019).

The requirements for excluding these large contributions from the determination of a charity's publicly supported status are hardly well-articulated. According to the Treasury regulations, "all pertinent facts and circumstances will be taken into consideration," and no single factor necessarily controls the determination. *Id.* § 1.170A-9(f)(6)(iii). However, "some of the factors similar to the factors to be considered" are those set forth in section 1.509(a)-3(c)(4) of the regulations. *Id.*

The section 1.509(a)-3(c)(4) Treasury regulations identify the following factors as relevant in determining whether a contribution is an unusual grant, although "all pertinent facts and circumstances will be taken into consideration":

> (i) Whether the contribution was made by any person (or persons standing in a relationship to such person which is described in section 4946(a)(1)(C) through 4946(a)(1)(G)) who created the organization, previously contributed a substantial part of its support or endowment, or stood in a position of authority, such as a foundation manager (within the meaning of section 4946(b)), with respect to the organization. A contribution made by a person other than those persons described in this paragraph (c)(4)(i) will ordinarily be given more favorable consideration than a contribution made by a person described in this paragraph (c)(4)(i);
>
> (ii) Whether the contribution was a bequest or an inter vivos transfer. A bequest will ordinarily be given more favorable consideration than an inter vivos transfer;
>
> (iii) Whether the contribution was in the form of cash, readily marketable securities, or assets which further the exempt purposes of the organization, such as a gift of a painting to a museum;
>
> (iv) Except in the case of a new organization, whether, prior to the receipt of the particular contribution, the organization has carried on an actual program of public solicitation and exempt activities and has been able to attract a significant amount of public support;
>
> (v) Whether the organization may reasonably be expected to attract a significant amount of public support subsequent to the particular contribution. In this connection, continued reliance on unusual grants to fund an organization's current operating expenses (as opposed to providing new endowment funds) may be evidence that the organization cannot reasonably be expected to attract future support from the general public;
>
> (vi) Whether, prior to the year in which the particular contribution was received, the organization met the one-third support test described in paragraph (a)(2) of this section without the benefit of any exclusions of unusual grants pursuant to paragraph (c)(3) of this section;
>
> (vii) Whether neither the contributor nor any person standing in a relationship to such contributor which is described in section 4946(a)(1)(C) through 4946(a)(1)(G) continues directly or indirectly to exercise control over the organization;
>
> (viii) Whether the organization has a representative governing body as described in § 1.509(a)-3(d)(3)(i); and

Case 4: Supporting an Existing, Unaffiliated Public Charity and Its Mission, in Part Through Lobbying

A foreign actor can handily circumvent the impediments surrounding the formation of a new charity that desires to lobby. One way to do so is by supporting an existing charitable organization that routinely lobbies. Consider Reasoned Rebels ("RR"), a charity that has long operated to educate the public about atheism. RR believes that stamping out official government exemptions from broadly applicable laws for religious objectors will help promote its atheistic worldview. Accordingly, RR devotes a portion of its resources to lobbying for the repeal of RFRA. RR has made the section 501(h) election and complies with its limitations on expenditures to influence legislation. RR is broadly supported by the general public and has a board of directors that draws upon a wide cross-section of the general public. Comrade Conrad, the same wealthy German socialist from *Case 3*, approaches RR. Conrad still desires to influence the American population to be receptive to communist thought so as to lay a foundation in which communist political philosophy is more likely to thrive. Conrad donates $100 million to RR.

The relevant difference between *Case 4* and *Case 3* is that in *Case 4*, RR can probably succeed in arguing that Conrad's donation is an unusual grant, thereby enabling RR to maintain its classification as a public charity, rather than a private foundation.[112] As such, RR can make the section 501(h) election, comply with its limitations, and still engage in legislative activities without jeopardizing its federal income tax exemption. And in *Case 4*, a foreign actor is indirectly wielding some degree of influence over the U.S. political process.

Case 5: Financially Supporting a New or Existing SO that Advances a Mission Aligned with the Foreign Actor's Interests, in Part Through Lobbying

A foreign actor desiring to circumvent the constraints on lobbying illustrated in *Case 3* is not limited to funding an existing charity. Assume the same facts in *Case 4*, except that Conrad, the same wealthy German socialist, donates $100 million to a section 509(a)(3) SO of RR (the "RRSO"). Whether or not RRSO is a newly formed SO or an existing entity, it is free to make the section 501(h) election and lobby within its limitations.[113] Further, because RRSO is an SO under section 509(a)(3), RRSO need not satisfy

> (ix) Whether material restrictions or conditions (within the meaning of § 1.507-2(a)(7)) have been imposed by the transferor upon the transferee in connection with such transfer.

Id. § 1.509(a)-3(c)(4).

112. See *supra* note 111 for a list of the factors relevant in determining whether a large donation constitutes an unusual grant.

113. *See* I.R.C. § 501(h)(4)(G).

the public support tests under sections 509(a)(1) and 170(b)(1)(A)(vi). Accordingly, RRSO need not convince the IRS that the contribution from Conrad is an unusual grant. Thus, in *Case 5*, a foreign actor is indirectly wielding some degree of influence over the U.S. political process without drawing attention to its large contribution to RRSO. Moreover, the governing board of RRSO can even include Conrad and those who are deferential to his wishes, as long as he and other disqualified persons do not control it.[114] RRSO need not pay its income directly to RR,[115] but instead may use its resources to support an activity benefiting RR, including an activity that serves members of RR's charitable class.[116]

Case 6: Exploiting a Charity's Relationship with Policymakers as a Non-Quid Pro Quo "Favor" for Financial Support

A foreign actor can also influence U.S. public policy in ways not yet illustrated by the preceding hypothetical cases. Consider the Thurston Howell Foundation (the "Foundation"), a large, publicly supported grant-making charity. The Foundation employs a senior staff of people who once served in various presidential administrations. At times, the Foundation receives a large gift from a donor who requests an informal and non-contractually binding "favor" from a staff member. Recently, a donor from Saudi Arabia gave $50 million to the Foundation and requested a charity officer to pressure senior staffers in the Department of State, with whom the official once worked, to advocate that Israel relinquish control of the West Bank. The Foundation's staff member has voluntarily complied with the request.

Despite the brazen attempt to influence U.S. policy in a politically charged matter, it is far from clear that the Foundation has violated its requirements for federal income tax exemption. First, more facts are required to determine whether the "favor" of imposing upon public officials was provided by the charity officer in her individual capacity or on behalf of the Foundation. If upper-level Foundation management encourages such antics, the behavior could be attributed to the Foundation itself. But merely tolerating this behavior is probably not enough to attribute it to the Foundation; every charity officer has a right to act on her own behalf, even if the act assists supporters of her employing entity in some way.

However, let us assume that the officer's acts are properly attributed to the charity because they are encouraged or directed by the Foundation. Are

114. *See id.* § 509(a)(3)(C). For example, if the corporate charter of RRSO states that the members of its board of directors are appointed by the board members of RR, the latter generally can appoint Conrad, his relatives, his lawyer, and his administrative assistant to the board of RRSO, as long as a majority of the board consists of those who are not disqualified persons. *See* Treas. Reg. § 1.509(a)-4(j)(1).

115. *See* Treas. Reg. § 1.509(a)-4(e)(2).

116. *See id.* § 1.509(a)-4(e)(1)–(2).

these acts problematic under the tax laws? We can readily dismiss the prospect that the activities are attempts to influence legislation, at least if no specific legislation involving Israel's occupation of the West Bank has been introduced in Congress or proposed for consideration by Congress. The communications in *Case 6* are directed solely to Department of State employees. "Legislation" generally refers to "action by the Congress, any state legislature, any local council, or similar legislative body."[117] Executive and administrative bodies are not included within the definition of "legislative body."[118]

Still, the Foundation is not yet out of the woods. It is conceivable that the Foundation is being used, at least in part, to further the private interests of the Saudi donor and others like him. Unlike previous cases, in *Case 6* the donor to the Foundation is not simply enabling the Foundation to conduct its charitable mission more effectively, thereby producing a natural byproduct that benefits the donor. Rather, the donor in *Case 6* is asking Foundation officers to provide a benefit that does not flow concomitantly from charitable operations.[119] Of course, the series of events lacks a strict quid pro quo structure. And it would be difficult to conclude that the Foundation is operated to any significant degree to further private interests if these "favors" by officers are infrequent.

However, the prohibition against private inurement of net earnings is literally absolute;[120] any inurement of the net earnings of a charity to the benefit of an insider constitutes grounds for revocation of federal income tax exemption. To illustrate, if a large donor is considered to have insider status with respect to the charity, the latter cannot pay its employees to paint the house of an insider. Similarly, a charity that provides an insider with free "government official influence" services through the charity's paid staff would, strictly speaking, run afoul of the prohibition against private inurement. Footing the bill for an employee's time devoted to serving a large donor is using the organization's resources to benefit the donor, whether the employee paints houses or instead pressures government officials on behalf of the donor.

Further, if the "government-influence" favors in *Case 6* are common, a private benefit problem—in addition to the private inurement problem—exists. Consistent with common law concepts of charity, charitable organizations are entitled to exemption only if they serve a public, rather than a private, interest.[121] Conceivably, the Foundation could be so extensively

117. *Id.* § 56.4911-2(d)(1)(i).

118. *Id.* § 56.4911-2(d)(3).

119. That is, the benefit to the Saudi donor is not qualitatively incidental.

120. *See* I.R.C. § 501(c)(3) (2012) (stating that "no part" of the tax-exempt charitable organization's net earnings may inure to the benefit of private individuals).

121. *See* Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii). For a concise summary of the private benefit doctrine and the prohibition of private inurement, see Johnny Rex Buckles, *When Charitable Gifts*

engaged in the business of extending political-connection favors that a court would find that it is primarily serving private interests.

Still, as a practical matter, it is doubtful that the political favors provided in *Case 6* would result in revocation of tax exemption. First, proving the Foundation used its resources in the manner indicated would be difficult, if for no reason other than that this use is hard to detect. Secondly, the Foundation could adopt an official policy that its staff must not approach government officials in the manner indicated on behalf of the charity itself. What the employees do on their own time is, under the law, their business. As long as the employees provide their political access favors on their own time and without prompting by the Foundation, it is unlikely that their actions will be attributed to the charity.

Case 7: A Foreign Government Directly Contributes to a Publicly Supported Charity that Attempts to Influence Executive Action

The antics depicted in *Case 6* suggest further opportunities for foreign actors to affect U.S. policy. Assume that the World Peace Association ("WPA") is a publicly supported educational organization seeking to promote global peace by fostering a better understanding and tolerance of people of various religious, economic, family, educational, and vocational backgrounds from around the world. Through the years, WPA has encouraged senior-level cabinet members and other officials in the executive branch to engage in expanded dialogue with nations whom the United States has not traditionally identified as allies. The Islamic Republic of Iran believes that, by supporting the operations of the WPA, U.S. public opinion can be shaped to become less skeptical of Iran, thereby creating a climate in which the U.S. government will find it more difficult to demand military concessions from the Iranian government. Iranian officials also reasonably believe that, by generously supporting WPA, its staff—consistent with its historic activities—will encourage U.S. executive branch officials to expand lines of communication with the Iranian government.

As in *Case 6*, the communications between the charitable donee (here, WPA) and officials of the executive branch in *Case 7* do not constitute attempts to influence legislation. "Legislation" is generally limited to action by a "legislative body,"[122] which does not include an executive or administrative body.[123]

What about unlawful private benefit and inurement of net earnings to the benefit of insiders? Assuming that a foreign sovereign is considered a

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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, 1844–46 (2003).

122. Treas. Reg. § 56.4911-2(d)(1)(i).

123. *Id.* § 56.4911-2(d)(3).

"private individual" for purposes of the prohibition against excessive private benefit and the prohibition against private inurement of net earnings,[124] it is unlikely that WPA would be found to have conferred an unlawful benefit on an insider. In this case, not only is there no formal quid pro quo, but also the benefits that the Iranian government anticipates will flow from WPA's historic, customary manner of acting. Unlike the government influence favors described in *Case* 6, in *Case 7* the activities of WPA that Iran is supporting advance the purpose of WPA.

WPA does need to attend to one matter, however. The gift that WPA receives from Iran is not counted as public support under the rules excluding publicly supported charities from private foundation status.[125] Hence, in order to maintain its nonprivate foundation classification as a public charity, WPA may be required to classify the contribution from Iran as an unusual grant. The ability to do so obviously limits the number of large grants from Iran that WPA can receive.

Case 8: A Foreign Government Directly Contributes to an SO that Attempts to Influence Executive Action

With a little tax planning, the Iranian government can avoid having to limit the number of its large grants, as required in *Case 7*. Consider the same facts in *Case 7*, except that WPA has an SO described in section 509(a)(3) that accepts the contribution from Iran. As in *Case 7*, there is no lobbying problem in *Case 8*, nor is there likely any violation of the private benefit doctrine or the prohibition against private inurement of net earnings. Unlike *Case 7*, however, WPA's SO in *Case 8* can accept repeated contributions from Iran without risking WPA's status as a publicly supported charity. In practice, a pattern of receiving extensive support from Iran through WPA's SO may well build goodwill between the officers of WPA and Iranian government officials, and this relationship in turn could spur additional contacts between WPA and federal executive branch officials in which WPA casts Iran in a positive light. In this manner, without engaging in any formal quid pro quo transaction or series of transactions, the Islamic Republic of Iran may

124. Foreign governments are not treated the same as domestic "governmental units" for a number of purposes under U.S. tax laws. *See, e.g.*, I.R.C. § 170(c)(1) (defining a charitable contribution to include a gift to a "State, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes").

125. *See* Treas. Reg. § 1.170A-9(f)(1)(ii) (defining a section 170(b)(1)(A)(vi) organization to include one that "[n]ormally receives a substantial part of its support from a governmental unit referred to in section 170(c)(1) or from direct or indirect contributions from the general public"). Section 170(c)(1) describes only domestic governmental units. *See* I.R.C. § 170(c)(1). The position of the IRS Chief Counsel is consistent with this conclusion. *See, e.g.*, I.R.S. Gen. Couns. Mem. 38,327 (Mar. 31, 1980); I.R.S. Gen. Couns. Mem. 37,001 (Feb. 10, 1977).

be able to foster a more favorable diplomatic climate between the United States and itself.

III. OVERVIEW OF HOW U.S. TAX LAW ADVANCES FIDUCIARY NORMS THROUGH FUNDAMENTAL EXEMPTION REQUIREMENTS AND THE FEDERAL EXCISE TAX REGIME

Part II illustrates myriad ways that foreign actors, including foreign governments, potentially can influence the U.S. political process and political actors. The reason current law permits this influence can be appreciated only by first grasping the basic design of the federal taxation of charities. Part III explains that the overall design of the tax system's regulation of charities is primarily to reinforce state law norms governing fiduciary behavior. Part III also explains how federal tax law's political activity constraints relate to this overall design.

A. Overview of State Law Fiduciary Duties and Norms

State law historically regulates charity fiduciaries[126] by subjecting them to fiduciary duties.[127] Two widely recognized duties that a charity fiduciary

126. The academic literature discussing the state law regulation of charity fiduciaries is extensive. *See, e.g.*, Carter G. Bishop, *The Deontological Significance of Nonprofit Corporate Governance Standards: A Fiduciary Duty of Care Without a Remedy*, 57 CATH. U. L. REV. 701 (2008); Evelyn Brody, *Agents Without Principals: The Economic Convergence of the Nonprofit and For-Profit Organizational Forms*, 40 N.Y.L. SCH. L. REV. 457 (1996); Evelyn Brody, *Charity Governance: What's Trust Law Got to Do with It?*, 80 CHI.-KENT L. REV. 641 (2005); Evelyn Brody, *The Limits of Charity Fiduciary Law*, 57 MD. L. REV. 1400 (1998) [hereinafter Brody, *The Limits*]; Evelyn Brody, *Whose Public? Parochialism and Paternalism in State Charity Law Enforcement*, 79 IND. L.J. 937 (2004); Nina J. Crimm, *A Case Study of a Private Foundation's Governance and Self-Interested Fiduciaries Calls for Further Regulation*, 50 EMORY L.J. 1093, 1133–44 (2001); Deborah A. DeMott, *Self-Dealing Transactions in Nonprofit Corporations*, 59 BROOK. L. REV. 131 (1993); James J. Fishman, *Improving Charitable Accountability*, 62 MD. L. REV. 218 (2003); Susan N. Gary, *Regulating the Management of Charities: Trust Law, Corporate Law, and Tax Law*, 21 U. HAW. L. REV. 593 (1999); Harvey J. Goldschmid, *The Fiduciary Duties of Nonprofit Directors and Officers: Paradoxes, Problems, and Proposed Reforms*, 23 J. CORP. L. 631 (1998); Henry B. Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. PA. L. REV. 497 (1981); Henry Hansmann, *The Evolving Law of Nonprofit Organizations: Do Current Trends Make Good Policy?*, 39 CASE W. RES. L. REV. 807 (1988–89); Robert A. Katz, *Let Charitable Directors Direct: Why Trust Law Should Not Curb Board Discretion Over a Charitable Corporation's Mission and Unrestricted Assets*, 80 CHI.-KENT L. REV. 689 (2005); Geoffrey A. Manne, *Agency Costs and the Oversight of Charitable Organizations*, 1999 WIS. L. REV. 227 (1999); Dana Brakman Reiser, *Director Independence in the Independent Sector*, 76 FORDHAM L. REV. 795 (2007); Norman I. Silber, *Nonprofit Interjurisdictionality*, 80 CHI.-KENT L. REV. 613 (2005); Linda Sugin, *Resisting the Corporatization of Nonprofit Governance: Transforming Obedience into Fidelity*, 76 FORDHAM L. REV. 893 (2007); Jeremy Benjamin, Note, *Reinvigorating Nonprofit Directors' Duty of Obedience*, 30 CARDOZO L. REV. 1677 (2009); Denise Ping Lee, Note, *The Business Judgment Rule: Should It Protect Nonprofit Directors?*, 103 COLUM. L. REV. 925 (2003).

127. *See* Mark L. Ascher, *Federalization of the Law of Charity*, 67 VAND. L. REV. 1581, 1587 (2014) ("State law imposes a variety of duties on charitable fiduciaries . . . ."); Lloyd Hitoshi Mayer & Brendan M. Wilson, *Regulating Charities in the Twenty-First Century: An Institutional Choice*

owes are the duty of loyalty and the duty of care (or prudent administration, in the case of a charitable trust).[128] One should also recognize a cluster of fiduciary obligations underlying the two fiduciary duties and requiring fiduciaries to advance a charitable mission (as "mission" is variously construed).[129] This Article refers to this family of mission obligations as "obedience norms."

1. The Duty of Loyalty

A charity fiduciary owes a duty of loyalty whether the charitable entity is organized as a trust or corporation.[130] Commonly, a director of a charitable nonprofit corporation must act in "good faith" and according to what she believes (or reasonably believes) is in the "best interests of the corporation."[131] When a charity enters into a transaction with a director in which she may personally profit, the duty of loyalty precludes her from profiting at the charity's expense.[132] Disinterested directors may also breach their duty of loyalty

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Analysis, 85 CHI.-KENT L. REV. 479, 491 (2010) (observing "there is general agreement that charity leaders owe their organizations two duties under state laws: care and loyalty" and further observing a duty of "obedience" that may not be entirely distinct from the other two).

128. *See, e.g.*, RESTATEMENT OF CHARITABLE NONPROFIT ORGS. § 2.02 cmt. a (AM. LAW INST., Tentative Draft No. 1, 2016) ("The twin duties of loyalty and care address the obligations that fiduciaries owe to advance a charity's purpose."). One book succinctly explains as follows in describing the duties of directors of a nonprofit corporation: "The duty of care and the duty of loyalty are the common terms . . . [to describe] the standards that guide all actions a director takes. These standards are derived from a century of litigation principally involving business corporations, but are equally applicable to nonprofit corporations." COMM. ON NONPROFIT CORPS., AM. BAR ASS'N, GUIDEBOOK FOR DIRECTORS OF NONPROFIT CORPORATIONS 19 (George W. Overton & Jeannie Carmedelle Frey eds., 2d ed. 2002).

129. Some commentators articulate this third cluster of obligations as a duty of obedience. *See, e.g.*, DANIEL L. KURTZ, BOARD LIABILITY: GUIDE FOR NONPROFIT DIRECTORS 21 (1988); Sugin, *supra* note 126, at 897–905 (discussing the duty of obedience as commonly understood). For analyses of the scope and purpose of a duty of obedience, see Rob Atkinson, *Obedience as the Foundation of Fiduciary Duty*, 34 J. CORP. L. 43, 45–47 (2008); Alan R. Palmiter, *Duty of Obedience: The Forgotten Duty*, 55 N.Y.L. SCH. L. REV. 457, 458–60 (2010). A distinct duty of obedience is rejected by the *Restatement of the Law of Charitable Nonprofit Organizations*. RESTATEMENT OF CHARITABLE NONPROFIT ORGS. § 2.02 cmt. e, subsec. (c), no. 17.

130. *See* RESTATEMENT OF CHARITABLE NONPROFIT ORGS. § 2.02. *See generally* Susan N. Gary, *Is It Prudent to be Responsible? The Legal Rules for Charities That Engage in Socially Responsible Investing and Mission Investing*, 6 NW. J.L. & SOC. POL'Y 106, 113–17 (2011) (explaining the duty of loyalty).

131. *See, e.g.*, CAL. CORP. CODE § 5231(a) (West 2012) (requiring a director to act "in good faith, [and] in a manner that director believes to be in the best interests of the corporation"); MASS. GEN. LAWS ANN. ch. 180, § 6C (West 2012) (imposing a nearly identical standard); OHIO REV. CODE ANN. § 1702.30(B) (West 2009) (stating that a director must act "in good faith, [and] in a manner the director reasonably believes to be in or not opposed to the best interests of the corporation"); 15 PA. CONS. STAT. § 5712(a) (1995) (requiring a director to act "in good faith, [and] in a manner he reasonably believes to be in the best interests of the corporation"); TEX. BUS. ORGS. CODE ANN. § 22.221(a) (West 2011) (imposing a similar standard).

132. This conclusion follows from the requirement that a fiduciary act in a manner that she "reasonably believes" is "in the best interests of the charity." RESTATEMENT OF CHARITABLE NONPROFIT ORGS. § 2.02(a).

by intentionally conferring a financial benefit on an interested director to the detriment of the charity.[133] When the interests of a charitable nonprofit corporation conflict with the interests of directors and related persons, the duty of loyalty encourages directors to follow procedural safeguards.[134]

Trustees of charitable trusts also owe a duty of loyalty.[135] Moreover, traditionally trustees are prohibited from engaging in self-dealing more rigidly than are corporate fiduciaries.[136]

2. *The Duty of Care*

The duty of care concerns diligence and prudence.[137] Under the Revised Model Nonprofit Corporation Act, a director must discharge her duties "with the care an ordinarily prudent person in a like position would exercise under similar circumstances,"[138] a standard largely consistent with those set forth in many state nonprofit corporation statutes.[139] The standard is also similar

133. To intentionally confer a benefit on another director to the detriment of the charitable organization is to act other than "in good faith and in a manner the fiduciary reasonably believes to be in the best interests of the charity." *Id.*

134. *See, e.g.*, MODEL NONPROFIT CORP. ACT § 8.60(a) (AM. BAR ASS'N. 2008) (stating that a conflict-of-interest transaction is not voidable if, in relevant part, the board is informed of material facts and a majority of disinterested directors approve the transaction); *id.* § 8.31(a)(1)(ii) (stating that an interested director incurs no liability if one of the procedures of § 8.60 has been followed). Generally, there is no outright prohibition against transactions between a director and the nonprofit corporation that she oversees. However, loans between a director or officer and the corporation that she oversees or manages are forbidden in states that follow the 1987 Revised Model Nonprofit Corporation Act. *See, e.g.*, REVISED MODEL NONPROFIT CORP. ACT § 8.32(a) (AM. BAR ASS'N. 1987). An optional provision in the more recent model act generally forbids such loans. *See, e.g.*, MODEL NONPROFIT CORP. ACT § 8.32(a).

135. Under the *Restatement (Third) of Trusts*, "[e]xcept as otherwise provided in the terms of the trust, a trustee has a duty to administer the trust . . . solely in furtherance of its charitable purpose." RESTATEMENT (THIRD) OF TRUSTS § 78(1) (AM. LAW INST. 2007). The duty of loyalty "strictly prohibit[s]" the trustee "from engaging in transactions that involve self-dealing or that otherwise involve or create a conflict between the trustee's fiduciary duties and personal interests" except in "discrete circumstances." *Id.* § 78(2).

136. *See id.* § 78 cmt. a ("The duty of loyalty is, for trustees, particularly strict even by comparison to the standards of other fiduciary relationships.").

137. *See* RESTATEMENT OF CHARITABLE NONPROFIT ORGS. § 2.03(a) ("A fiduciary of a charity has a duty to act in good faith with the care a person of ordinary prudence in a like position would exercise under similar circumstances."); *id.* § 2.02 cmt. a ("The duty of care, described in § 2.03, ordinarily involves mismanagement, inattention, and other improper decision making that causes harm to the charity.").

138. REVISED MODEL NONPROFIT CORP. ACT § 8.30(a)(2). Under the third edition of the Model Nonprofit Corporation Act, directors "must discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances." MODEL NONPROFIT CORP. ACT § 8.30(b).

139. *See, e.g.*, CAL. CORP. CODE § 5231(a) (West 2019) (requiring a director to act "with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances"); MASS. GEN. LAWS ANN. ch. 180, § 6C (West 2019) (requiring a director to act "with such care as an ordinarily prudent person in a like position with respect to a similar corporation organized under this chapter would use under similar circumstances"); MICH. COMP. LAWS ANN. § 450.2541 hist. nn. (West 2019) (stating that a director must discharge her duties "with

to the traditional trust law analogue, the duty of prudent administration, which governs fiduciaries of charitable trusts. Under the *Restatement (Third) of Trusts*, a trustee is required to "administer the trust as a prudent person would, in light of the purposes, terms, and other circumstances of the trust."[140] In administering the trust in compliance with this duty, the trustee generally must exercise "reasonable care, skill, and caution."[141]

3. Fiduciary Obedience Norms

Fiduciary obligations with respect to obedience relate to adherence to mission or charter purpose. The legally binding nature of obedience norms varies with the type of charitable entity (e.g., charitable trust or nonprofit corporation) and the jurisdiction and context in which the fiduciary acts. This article employs the taxonomy of fiduciary obedience norms I have articulated previously: (1) the legality norm (i.e., obey the law); (2) the dynamic charter fidelity norm (i.e., obey the charter, as amended from time to time); (3) the static charter fidelity norm (i.e., obey the charter and do not amend it without advance, substantive government approval); (4) the historic mission fidelity norm (i.e., advance the charity's historic mission, even if it is narrower than charter purposes); (5) the dynamic mission fidelity norm (i.e., advance the charity's mission as it may evolve over time); and (6) the "charity advancement norm" and its negative corollary.[142]

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the degree of diligence, care, and skill that an ordinarily prudent person would exercise under similar circumstances in a like position"); N.Y. NOT-FOR-PROFIT CORP. LAW § 717(a) (McKinney 2019) (imposing an essentially similar standard); OHIO REV. CODE ANN. § 1702.30(B) (West 2019) (stating that a director must act "with the care that an ordinarily prudent person in a like position would use under similar circumstances"); 15 PA. CONS. STAT. § 5712(a) (2019) (requiring a director to exercise "reasonable inquiry, skill and diligence, as a person of ordinary prudence would use under similar circumstances"); TEX. BUS. ORGS. CODE ANN. § 22.221(a) (West 2019) (requiring a director to act "with ordinary care").

140. RESTATEMENT (THIRD) OF TRUSTS § 77(1).

141. *Id.* § 77(2). If the trustee has "special facilities or greater skill than that of a person of ordinary prudence, [then] the trustee has a duty to use such facilities or skill." *Id.* § 77(3).

142. *See, e.g.*, Johnny Rex Buckles, *How Deep Are the Springs of Obedience Norms that Bind the Overseers of Charities*, 62 CATH. U.L. REV. 913, 921–25 (2013) [Buckles, *Deep Springs*]; Johnny Rex Buckles, *The Federalization of Fiduciary Obedience Norms in Tax Laws Governing Charities: An Introduction to State Law Concepts and an Analysis of Their Implications for Federal Tax Law*, 4 EST. PLAN. & COMMUNITY PROP. L.J. 197, 206–13 (2012) [Buckles, *Obedience Norms*]. By way of elaboration, the requirement that fiduciaries direct their charities to operate lawfully is the "legality norm." Requiring fiduciaries to ensure a charity operates in accordance with its governing instrument—as it may be amended from time to time by the fiduciaries, the charity's members, or both, who may so act without first receiving substantive approval of the amendment from a governmental institution or official—is the "dynamic charter fidelity norm." Requiring fiduciaries to ensure a charity operates in accordance with its governing instrument—as it was originally drafted and as it may be amended only with the substantive approval of a governmental actor—is the "static charter fidelity norm." A requirement that fiduciaries cause their charities to adhere to the charities' precise historic missions, even when they are more limited than the charitable purposes recorded in charities' governing instruments, is the "historic mission fidelity norm." The "dynamic mission fidelity norm," by contrast, is a requirement that fiduciaries cause their charities to operate

Obedience norms governing trustees of trusts are fairly settled. The law of private trusts largely subsumes the norm of static charter fidelity[143] circumscribed by the legality norm.[144] The law of charitable trusts also embraces both of these norms through the duty of loyalty, under which a trustee must administer the trust "solely in furtherance of its charitable purpose"[145] and the doctrine of cy pres.[146]

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in accordance with the charities' precise charitable mission(s) as the governing board expands, contracts, or otherwise alters the mission(s) from time to time. The charity advancement norm and its negative corollary are elements or sub-norms of the other identified obedience norms and are more fully explained *infra*.

143. Under the *Restatement (Third) of Trusts*, a trustee "has a duty to administer the trust, diligently and in good faith, in accordance with the terms of the trust and applicable law." RESTATEMENT (THIRD) OF TRUSTS § 76(1). The official comments to this *Restatement* rule refer to the duty as the "normal duty of a trustee to obey the terms of the trust." *Id.* § 76(1) cmt. b(1).

144. The law of private trusts invalidates terms of trust that are illegal. *See, e.g.*, *id.* § 29(a) (stating that a trust or trust provision is invalid if "its purpose is unlawful or its performance calls for the commission of a criminal or tortious act"); RESTATEMENT (SECOND) OF TRUSTS § 60 (AM. LAW INST. 1959) ("An intended trust or a provision in the terms of a trust is invalid if *illegal*." (emphasis added)); *id.* § 61 ("An intended trust or a provision in the terms of the trust is invalid if the performance of the trust or of the provision involves the commission of a criminal or tortious act by the trustee."). The law also invalidates terms of a trust that violate public policy. *See* RESTATEMENT (THIRD) OF TRUSTS § 29(c) (stating that a trust or trust provision is invalid if "it is contrary to public policy"); RESTATEMENT (SECOND) OF TRUSTS § 62 ("A trust or a provision in the terms of a trust is invalid if the enforcement of the trust or provision would be against public policy, even though its performance does not involve the commission of a criminal or tortious act by the trustee."). Further, a trustee of a private trust is not under a duty to comply with a trust provision that is unlawful or contrary to public policy, and indeed is generally under a duty not to comply with such a provision. *See* RESTATEMENT (THIRD) OF TRUSTS § 72 cmt. b.

145. RESTATEMENT (THIRD) OF TRUSTS § 78(1).

146. Under the doctrine of cy pres, trustees may deviate from the dispositive terms of a charitable trust only in limited circumstances, and not without first receiving judicial approval to do so. Under the traditional doctrine of cy pres, a court may direct charity fiduciaries to devote trust funds to purposes similar to the original charitable purposes when accomplishing the original purposes becomes impossible, impracticable, or illegal, as long as the original donor "has manifested an intent to devote the funds to charitable purposes more general than the frustrated specific" charitable purpose. Johnny Rex Buckles, *supra* note 121, at 1834, 1834 n.28 (citing RESTATEMENT (SECOND) OF TRUSTS § 399), *see also* Sharpless v. Medford Monthly Meeting of the Religious Soc'y of Friends, 548 A.2d 1157, 1160 (N.J. Super. Ct. App. Div. 1988); *cf.* GEORGE G. BOGERT & GEORGE T. BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 438 (2d rev. ed. 1991) (stating that the doctrine applies when, in relevant part, furthering the donor's specific intent "is or becomes impossible, impractical, or inexpedient"); AUSTIN W. SCOTT ET AL., 6 SCOTT AND ASCHER ON TRUSTS § 39.5.2 (2010) [hereinafter SCOTT AND ASCHER ON TRUSTS] (stating that cy pres may be applied when it "is unlawful, impossible, impracticable, or wasteful to carry out" the settlor's particular charitable purposes).

> The doctrine is sometimes articulated as involving three prongs: (i) property is gratuitously transferred in trust for a designated charitable purpose; (ii) carrying out the designated purposes of the gift is, or becomes, impossible, impracticable, or illegal; and (iii) the trustor manifested a general intention to devote the gifted property to charitable purposes.

Buckles, *supra* note 121, at 1834 n.28 (citing 15 AM. JUR. 2D *Charities* § 149 (2002)). Even if trustees believe that grounds for applying cy pres exist, they must obtain permission from a court to deviate from express charitable purposes. *See* RESTATEMENT (THIRD) OF TRUSTS § 67.

The law of obedience norms governing directors of nonprofit corporations is more nuanced. Typically imposing no express statutory "duty of obedience" on directors of charitable corporations,[147] state nonprofit laws nonetheless embrace several obedience norms. First, state laws enforce the legality norm.[148] Second, state nonprofit corporation laws often impose flexible norms of charter fidelity. For example, directors of a nonprofit charitable corporation must not cause the entity to act contrary to its corporate purposes (i.e., directors must obey corporate charters),[149] but amendments to corporate charters, including purposes clauses, are often permitted through compliance

The *Restatement (Third) of Trusts* and the Uniform Trust Code alter the traditional common law doctrine of cy pres by adding wastefulness to the grounds for applying the doctrine and presuming that a donor possesses general charitable intent, but they otherwise follow the traditional doctrine of cy pres. RESTATEMENT (THIRD) OF TRUSTS § 67 cmt. b (describing the modern rule as "displacing the traditional quest for a settlor's 'general charitable intent' when the trust" is silent); UNIF. TRUST CODE § 413 (NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 2010).

Related to the doctrine of cy pres is the doctrine of deviation (or "equitable deviation"), under which a court can

> direct . . . a trustee of a charitable trust to deviate from the administrative terms of trust if compliance with the original terms is impossible or illegal, or if compliance with the terms of trust would substantially impede the accomplishment of trust purposes on account of circumstances that the settlor did not foresee.

Buckles, *supra* note 121, at 1834 n.26 (citing RESTATEMENT (SECOND) OF TRUSTS § 381 cmt. a; MacCurdy-Salisbury Educ. Fund v. Killian, 309 A.2d 11, 13–14 (Conn. Super. Ct. 1973)); *see also* RESTATEMENT (THIRD) OF TRUSTS § 66(1) cmt. c (expanding the doctrine to authorize deviation from terms that are not merely administrative).

147. *See, e.g.*, TEX. BUS. ORGS. CODE ANN. § 22.221(a) (West 2019) (setting forth fiduciary standards governing directors).

148. Nonprofit corporations generally must act in accordance with the law. *See, e.g.*, TEX. BUS. ORGS. CODE ANN. § 2.003(1)(A) (stating that a domestic entity may not engage in an "activity that . . . is expressly unlawful or prohibited by a law of this state"). Fiduciaries who deliberately cause corporations to act unlawfully generally breach their statutory fiduciary duties. *See, e.g.*, *id.* § 22.221.

149. *See* Fishman, *supra* note 126, at 237. Thus, in Texas, the state attorney general may sue to enjoin action inconsistent with charter purposes, and a corporation may sue a director who causes a corporation to act outside of its corporate purposes. *See* TEX. BUS. ORGS. CODE ANN. § 20.002(c)(2), (3)(B). Similarly, the 1987 Revised Model Nonprofit Corporation Act and the more recent third edition of the Model Nonprofit Corporation Act permit certain lawsuits when a corporation is alleged to have acted outside of its powers. *See, e.g.*, MODEL NONPROFIT CORP. ACT § 3.04 (AM. BAR ASS'N. 2008); REVISED MODEL NONPROFIT CORP. ACT § 3.04 (AM. BAR ASS'N. 1987); *cf.* TEX. BUS. ORGS. CODE ANN. § 2.113 (stating that the statutory section specifying a domestic entity's powers "does not authorize a domestic entity or a managerial official of a domestic entity to exercise a power in a manner inconsistent with a limitation on the purposes or powers of the entity contained in its governing documents, this code, or other law of this state").

with specified internal procedures.[150] Thus, state nonprofit statutes commonly appear to embrace the dynamic charter fidelity norm[151] at least in many, if not most, contexts.[152] In those states, the dynamic mission fidelity norm would also logically be favored over the historic mission fidelity norm.

The two charter fidelity norms and the two mission fidelity norms have a common requirement: Charity fiduciaries must advance charitable purposes. All charter and mission fidelity norms require fiduciaries to navigate charities in a general charitable direction.[153] Thus, a constitutive, underlying norm is the "charity advancement norm," applicable to both charitable trusts and charitable corporations.[154] In addition to imposing a mandate on fiduciaries to advance a charitable purpose, the charity advancement norm has a negative corollary: Charity fiduciaries must not act so as to advance primarily a non-charitable purpose.[155]

B. Fundamental Exemption Requirements

In important respects, state law fiduciary duties and their underlying obedience norms are reinforced through the fundamental requirements for obtaining and maintaining federal income tax exemption, as well as through the federal excise taxes applicable to charities and their fiduciaries.[156] This

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150. *See, e.g.*, TEX. BUS. ORGS. CODE ANN. § 22.105 (specifying procedures for amending the certificate of formation for a corporation with members having voting rights); *id.* § 22.106 (specifying procedures for amending the certificate of formation for a corporation whose management is vested in members); *id.* § 22.107 (specifying procedures for amending the certificate of formation by the board of directors).

151. There are exceptions. For example, in New York, amendments to the purposes clause in a charity's corporate charter require judicial approval. *See, e.g.*, N.Y. NOT-FOR-PROFIT CORP. LAW § 804(a)(ii) (McKinney 2019) (requiring further that the state attorney general receive notice of an application for judicial approval of the charter amendment). Accordingly, New York implements the static charter fidelity norm instead of the dynamic charter fidelity norm. For a discussion of how some states have limited the ability of nonprofit hospitals to change their historic purposes, see Brody, *The Limits*, *supra* note 126, at 1465–76.

152. State law does not consistently embrace the dynamic charter fidelity norm in the case of nonprofit corporations. Rather, courts in some states, at least in some contexts, have followed the more rigid static charter fidelity norm (and, arguably in one case, the historic mission fidelity norm). For a discussion, see Buckles, *Deep Springs*, *supra* note 142, at 925–27.

153. Buckles, *Deep Springs*, *supra* note 142, at 924.

154. *Id.*

155. *Id.*

156. Professor Mark Ascher makes a comparable point:

> [T]here are numerous ways in which federal law seeks to, and no doubt does, deter fiduciary misconduct involving charities. The very same tax provisions that identify entities as charitable require not only that they be *organized* to pursue certain defined charitable objectives but also that they be *operated* to do so.

Ascher, *supra* note 127, at 1591 (footnote omitted) (citing separate works of Professors Evelyn Brody, Johnny Rex Buckles, and Henry Hansmann).

Similarly, I have elsewhere argued that the federal tax system, in important respects, federalizes the duty of loyalty and fiduciary obedience norms. *See, e.g.*, Buckles, *Obedience Norms*, *supra* note 142, at 220–41; Buckles, *Duty of Loyalty*, *supra* note 52, at 653–62, 665–81. The discussion

Section explains how these design elements of our federal tax system that do not expressly limit political activities essentially federalize fiduciary duties and norms.

1. Organizational and Operational Tests

The organizational test and operational test of the U.S. Treasury regulations obviously embrace the charity advancement norm. Indeed, these tests literally require an entity to advance charitable goals to qualify for federal income tax exemption.[157] But the tests neither impose a particular norm of charter fidelity nor require mission fidelity.[158]

By embracing the charity advancement norm, the organizational and operational tests also encourage fiduciaries to comply with their duty of loyalty. Under the *Restatement (Third) of Trusts*, the duty of loyalty generally requires a trustee of a charitable trust to administer it "solely in furtherance of its charitable purpose."[159] Similarly, in articulating the duty of loyalty, the *Restatement of the Law of Charitable Nonprofit Organizations* declares that the duty of loyalty of charitable fiduciaries is to the charity's purposes.[160] To compel a charity's board to govern for charitable purposes is to require the board to govern the charity in a manner that satisfies the heart of the operational test of the Treasury regulations. In other words, the operational test conditions federal income tax exemption upon operating in a manner consistent with how an entity functions when its managers faithfully follow the charity advancement norm in compliance with their duty of loyalty.

Mere compliance with the duty of loyalty is not always sufficient to satisfy the operational test, however. The failure to exercise the fiduciary duty of care could also cause an organization to fail the operational test.[161] For example, consider a charity board that tries to advance a charitable purpose

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that follows in part summarizes the most relevant of these arguments, and in part extends them to explain the Code's selective incorporation of fiduciary care norms.

157. *See* Treas. Reg. § 1.501(c)(3)-1(b)(1)(i)(a) (2019).

158. Although an organization must be organized "[for] one or more exempt purposes," *id.* § 1.501(c)(3)-1(b)(1)(i)(a), and must "engage[] primarily in activities which accomplish one or more of such exempt purposes," *id.* § 1.501(c)(3)-1(c)(1), the regulations do not specifically require an entity to advance the exempt purposes for which it is organized. However, the regulations do assume that charter purposes are legally binding; otherwise, the organizational test would be pointless. The regulations thereby require an entity to advance some charitable purpose, and further assume that it will do so pursuant to its charter. The most logical inference is that the organizational and operational tests assume no more than the dynamic charter fidelity norm.

159. RESTATEMENT (THIRD) OF TRUSTS § 78(1) (AM. LAW INST. 2007). Similarly, under the *Restatement (Second) of Trusts*, a trustee must administer the trust "solely in the interest of effectuating the charitable purposes (see § 170)." RESTATEMENT (SECOND) OF TRUSTS §379 cmt. a (AM. LAW INST. 1959).

160. RESTATEMENT OF CHARITABLE NONPROFIT ORGS. § 2.02(a) (AM. LAW INST. Tentative Draft No. 1, 2016).

161. In addition, an organization fails the operational test if it is an "*action* organization." *See* Treas. Reg. § 1.501(c)(3)-1(c)(3)(i)-(iv).

primarily by funding the entire operations of a homeless shelter, but the board fails to monitor the use of its funds. Assume further that responsible oversight by the board readily would have revealed that the director of the homeless shelter consistently diverted the bulk of funds to pay for basketball game tickets for people whom he randomly encountered on the streets and in parks. The operational test of the Treasury regulations requires the charity to "engage[] primarily in activities which accomplish . . . exempt purposes."[162] The charity fails this standard, not because its managers sought to enrich a private actor or otherwise advance a noncharitable mission, but because they failed to exercise due care in monitoring the use of funds. Breaching the duty of care thus may lead to failing the operational test. In contrast, when a charity board fulfills both its duty of loyalty and its duty of care, compliance with the operational test is much more probable.[163]

2. *Prohibition Against Excessive Private Benefit and Any Private Inurement of Net Earnings*

The private benefit doctrine and the prohibition against private inurement of net earnings help ensure that charities serve public interests,[164] thereby promoting the charity advancement norm. A charity fiduciary that is barred from advancing the private interests of others is more likely to continue advancing charitable purposes.[165] For the same reason, the private benefit doctrine and the private inurement doctrine implement in part the negative corollary of the charity advancement norm. To run afoul of these doctrines is to operate in a "noncharitable" manner.

The private benefit doctrine also corresponds in important respects to the duty of loyalty governing charity fiduciaries. To require a fiduciary to act in the best interests of a charity is obviously to forbid her from the disloyal act of seeking to advance the best interests of others. For several reasons, the prohibition against private inurement even more closely corresponds to the duty of loyalty.[166]

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162. *Id.* § 1.501(c)(3)-1(c)(1).

163. Of course, it is possible that even compliance with the duty of care and the duty of loyalty will not suffice to ensure that a charity meets the operational test in unusual circumstances.

164. *Cf.* Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) ("An organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph unless it serves a public rather than a private interest.").

165. Professor Sugin has made a similar point. *See* Sugin, *supra* note 126, at 918.

166. First, as to scope, the prohibition against private inurement applies only to those with a measure of control over the charity's operations, such as a charity's governing board members and senior officers (who are subject to fiduciary duties). *See* United Cancer Council, Inc. v. Comm'r, 165 F.3d 1173, 1176 (7th Cir. 1999). Secondly, as to substance, the prohibition against private inurement forbids conferring a financial benefit upon an insider to the charity's detriment, characteristically in a transaction featuring an unfair bargain to the charity. *See, e.g.*, Mabee Petroleum Corp. v. United States, 203 F.2d 872, 875–77 (5th Cir. 1953) (payment of excessive compensation to insider); Founding Church of Scientology v. United States, 412 F.2d 1197, 1202 (Ct. Cl. 1969)

Once again, one can imagine situations when excessive private benefit or private inurement results from a breach of the duty of care, rather than a breach of the duty of loyalty. However, in many contexts a breach of the duty of loyalty will best explain why private inurement has occurred or excessive private benefit has been conferred. And when it does not, the private inurement or private benefit will often be explained by a breach of the duty of care. In any case, the prohibitions against private inurement and excessive private benefit prod charity fiduciaries to properly discharge their fiduciary duties of loyalty and care.

3. The Public Policy and Illegality Doctrines

The public policy doctrine (and its cousin, the illegality doctrine) incorporate an enhanced version of the legality norm into section 501(c)(3). Under the public policy doctrine and the illegality doctrine, law and "established public policy" constrain the scope of exempt purposes (and operations) under section 501(c)(3).[167] To breach the law or established public policy is thus to violate the legality norm or the supra-legality norm that *Bob Jones University v. United States* imposes on all section 501(c)(3) entities.[168]

C. Federal Excise Tax Provisions: In General

The federal excise tax regime is a complex legal web governing several types of charitable entities and a variety of activities and transactions in which they might engage.[169] Most of the excise taxes are what have been described judicially as "regulatory taxes," for their primary object is to regulate behavior, not to generate revenue.[170] This Section analyzes the features of the federal excise tax system that do not limit political activities of charitable organizations.

(payment of excessive rent to insider). The duty of loyalty prevents fiduciaries from intentionally doing the same. Third, as to process, the procedural safeguards incentivized by modern corporation statutes to ensure compliance with the duty of loyalty are designed to prevent the exploitation of charities in a way that would give rise to private inurement under federal tax law. *See, e.g.*, MODEL NONPROFIT CORP. ACT § 8.60(a) (AM. BAR ASS'N. 2008). Thus, the prohibition against private inurement in important respects largely subsumes the duty of loyalty. *See also* Ascher, *supra* note 127, at 1591 (stating that enforcement of the prohibition against private inurement "directly mimics the state law duty of loyalty").

167. Bob Jones Univ. v. United States, 461 U.S. 574, 586 (1983); *see also supra* notes 45–49 and accompanying text.

168. *See Bob Jones Univ.*, 461 U.S. at 586–87. The precise scope of this federal supra-legality norm is unknown, however. For extensive discussions of the uncertain scope of the public policy doctrine, see Buckles, *Law Schools*, *supra* note 49, at 27–35; Buckles, *Reforming*, *supra* note 49, at 407–37; Buckles, *Religious Schools*, *supra* note 49, at 276–78.

169. *Cf.* Ascher, *supra* note 127, at 1619 ("[T]he mind-numbingly complex patchwork of federal excise taxes leaves one wondering how things ever got so screwed up.").

170. *See, e.g.*, Seven-Sky v. Holder, 661 F.3d 1, 42 (D.C. Cir. 2011) (Kavanaugh, J. dissenting) (explaining regulatory taxes).

Some general themes emerge from an examination of the haphazard approach to the Code's imposition of excise taxes on disfavored conduct. The federal excise tax regime is an (imperfect) attempt to ensure that charity fiduciaries adhere to the charity advancement norm and its negative corollary.[171] The excise tax system in some respects federalizes the duty of loyalty,[172] although it does so by essentially imposing three different standards on charity managers, depending on context: (1) supra-trustee standards; (2) trustee standards; and (3) nonprofit-corporate-director standards. The excise tax system in some circumstances also effectively but selectively imposes a duty of care.

1. *Direct Promotion of the Charity Advancement Norm, Its Negative Corollary, and the Duty of Loyalty*

Several excise tax provisions impose norms of loyalty and obedience to charitable purpose. Section 4942, applicable to private foundations, directly promotes the charity advancement norm.[173] Section 4942 essentially imposes an excise tax on a private foundation's failure to distribute five percent of the net fair market value of its investment assets to accomplish charitable purposes.[174] Similarly, the Pension Protection Act of 2006[175] requires the Department of the Treasury to publish regulations on the payout required of Type III SOs that are not functionally integrated[176] with their supported organizations. The IRS has published regulations implementing this congressional mandate.[177]

The mandatory payout rules imposed on private foundations and certain SOs promote the charity advancement norm by requiring these entities to ex-

171. *Cf.* Ascher, *supra* note 127, at 1597 (stating that the federal excise taxes "encourage those who run charities to operate them *as* charities").

172. *See id.* ("One can fairly say that many of these [excise] taxes enforce the duty of loyalty and any number of other fiduciary duties, albeit at the federal level.").

173. *See generally* I.R.C. § 4942 (2012).

174. *See id.* § 4942(a), (c)–(e). Technically, the tax is imposed on "undistributed income" for any taxable year, which has not been distributed before the first day of the second (or any succeeding) taxable year following the taxable year in question. *See id.* § 4942(a). "Undistributed income" means the excess of the foundation's "distributable amount" over its "qualifying distributions" for the relevant year. *See id.* § 4942(c)(1)–(2). These terms, in turn, are statutorily defined so as to produce the rule described in the text accompanying this note.

175. Pension Protection Act of 2006, § 1241(d), Pub. L. No. 109-280, 120 Stat. 780.

176. Generally, an SO meets the integral part test as a functionally integrated Type III SO if it engages in certain activities that would normally be engaged in by the SO's supported organization(s) but for the SO's involvement. *See* Treas. Reg. § 1.509(a)-4(i)(4)(i)-(v) (2019). Substantially all of these activities in which the SO engages must directly further the exempt purposes of the supported organization(s) for which the SO is responsive by virtue of the SO's performing the functions of such supported organization(s) or by virtue of the SO's carrying out the purposes of such supported organization(s). *See id.*

177. *See* Treas. Reg. § 1.509(a)-4(i)(5)–(9).

pend annually at least a specified fraction of their assets to accomplish charitable purposes. Although the statutorily determined quantum of payout may be largely arbitrary, it generally ensures that charitable activities will be consistently funded. Further, because the charity advancement norm is subsumed within the duty of loyalty governing charity fiduciaries, it is also appropriate to view section 4942 as a federalization of the duty of loyalty, in part. Nonetheless, this federalization of fiduciary norms is far from comprehensive. Unaffiliated public charities, Type I SOs, Type II SOs, functionally integrated Type III SOs, and DAFs are not subject to a statutory payout rule.

Several excise tax provisions also directly promote the negative corollary of the charity advancement norm. The two most obvious rules govern private foundations and DAFs.[178] First, the section 4945 excise tax on "taxable expenditures" applies to any amount paid or incurred for any non-charitable purpose.[179] Similarly, section 4966 imposes an excise tax on "taxable distributions" made by a DAF. A taxable distribution includes a distribution from a DAF for any purpose other than one specified in section 170(c)(2)(B) (i.e., a charitable purpose).[180] The taxes apply both to the entities[181] and their fiduciaries.[182] Insofar as these taxes discourage those who control private foundations and DAFs from using resources to further any non-charitable goal, the taxes plainly and directly enforce the negative corollary of the charity advancement norm.[183] In so doing, these taxes also federalize the duty of loyalty by encouraging fiduciaries to act solely to further a charitable purpose.

Other excise tax rules, namely, those imposing a market-value standard on conflicts-of-interest transactions between a charitable entity and various charity insiders, also partially advance the negative corollary of the charity advancement norm and serve to federalize the duty of loyalty analogously to the prohibition against private inurement and the private benefit doctrine.[184] One obvious example is the excess benefit transactions excise tax ("EBTET") generally imposed by section 4958. Section 4958, which applies to charities

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178. *See generally* I.R.C. §§ 4945–4966.

179. *Id.* § 4945(d)(5).

180. *See id.* § 4966(c)(1)(B)(i).

181. *See id.* §§ 4945(a)(1), (b)(1); 4966(a)(1).

182. *See id.* §§ 4945(a)(2), (b)(2); 4966(a)(2).

183. *Cf.* Ascher, *supra* note 127, at 1599 ("Plainly, the primary target of the tax [on taxable expenditures by a private foundation] is activity that is, or arguably is, not 'charitable,' at least in the sense that federal tax law specifies.").

184. *See supra* Section III.B.2.

other than private foundations, imposes a tax on each "excess benefit transaction."[185] Such a transaction is one "in which an economic benefit is provided by an applicable tax-exempt organization[186] directly or indirectly to or for the use of any disqualified person[187] if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit."[188] By taxing the amount of an excess benefit[189] conferred on disqualified persons, section 4958 discourages the diversion of charitable assets to private hands. The provision thus reinforces the duty of loyalty and the negative corollary of the charity advancement norm.[190]

A special excise tax rule applicable to the payment of compensation by private foundations accomplishes a similar objective. Most transactions between a private foundation and a "disqualified person"[191] with respect to the foundation (e.g., fiduciaries of the foundation, its large donors, and their family members) are effectively prohibited by a federal self-dealing excise tax, which is more restrictive than the EBTET.[192] Such provisions impose trustee and supra-trustee standards pursuant to a federalized duty of loyalty. However, a private foundation's payment to a disqualified person of non-excessive compensation for personal services, which are reasonable and necessary to carry out the foundation's exempt purposes, is not taxable.[193] The category

185. *See* I.R.C. § 4958(a)(1)–(2), (b).

186. An applicable tax-exempt organization is essentially any tax-exempt organization otherwise described in section 501(c)(3), (4), or (29), other than a private foundation. *See id.* § 4958(e)(1)–(2).

187. Although special rules apply in the case of DAFs and SOs, in general, a disqualified person is one "who was, at any time during the 5-year period ending on the date of such transaction, in a position to exercise substantial influence over the affairs of the organization." *Id.*§ 4958(f)(1)(A). A disqualified person also includes members of the family of the one with substantial influence, *see id.* § 4958(f)(1)(B), (f)(4), and business entities in which the foregoing have significant ownership or control, *see id.* § 4958(f)(1)(C), (f)(3).

188. *Id.* § 4958(c)(1)(A).

189. *See id.* § 4958(a)(1).

190. *Cf.* Ascher, *supra* note 127, at 1600 (stating that the taxes imposed by section 4958 "mimic both the duty of loyalty and the duty to administer the charity in accordance with its terms and governing law.").

191. A disqualified person includes an officer or director of the private foundation, *see* I.R.C. § 4946(a)(1)(B)–(b)(1), any substantial contributor to the foundation, *see id.* § 4946(a)(1)(A), a member of the family of the foregoing, *see id.* § 4946(a)(1)(D), and entities in which any of the foregoing hold an ownership interest exceeding thirty-five percent, *see id.* § 4946(a)(1)(E)–(G). A disqualified person also includes those whose ownership interest in a substantial contributor exceeds twenty percent, *see id.* § 4946(a)(1)(C), and a member of the family of any such owner, *see id.* § 4946(a)(1)(D). A "substantial contributor" to a private foundation is, in general, someone who has given more than $5000 to the foundation, if her cumulative gifts exceed two percent of total gifts received by the foundation through the close of the year in which the contributor has made gifts to the foundation. *See id.* §§ 507(d)(2)(A), 4946(a)(2).

192. *See id.* § 4941(a)(1)–(2), (b)(1)–(2).

193. *See id.* § 4941(d)(2)(E).

of "personal services" is defined as services of a "professional and managerial" nature.[194] By effectively taxing only excessive compensation paid to disqualified persons providing personal services, this special rule functions similarly to the EBTET regime governing most charities; it partially advances the negative corollary of the charity advancement norm by prohibiting the diversion of foundation assets into private hands. In so doing, the special provision also represents another instance of the federalization of the duty of loyalty.

2. Over-Inclusive Promotion of the Negative Corollary of the Charity Advancement Norm and the Duty of Loyalty

In a number of ways, the federal excise tax regime promotes the negative corollary of the charity advancement norm over-inclusively. A federal tax rule that effectively prohibits fiduciaries from directing their charities to engage in activities that are not necessarily inconsistent with furthering a charitable purpose, but in some cases could be, is an "over-inclusive" rule embracing the negative corollary of the charity advancement norm.

Several rules governing conflict of interest transactions are representative. A prime example is the excise tax on most acts of self-dealing between a disqualified person and a private foundation.[195] Consider the sale of land by a private foundation's director to the private foundation itself. Such a sale is a taxable act of self-dealing, even if the sales price is at or below fair market value.[196] The excise tax provision not only effectively bars sales that exploit the foundation, but also forecloses those that would benefit it. In imposing this duty-of-loyalty trustee standard,[197] Congress apparently thought that the potential to exploit a private foundation justifies an over-inclusive rule.[198]

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194. Madden v. Comm'r, 74 T.C.M. (CCH) 440, 449 (1997); *see also* Rev. Rul. 74-591, 1974-2 C.B. 385 (ruling that the payment of a pension to a disqualified person was not an act of self-dealing when his personal services consisted of general administration, bookkeeping, investment counseling, disbursing funds, and managing real estate).

195. *See* I.R.C. § 4941.

196. *See id.* § 4941(d)(1)(A).

197. *See* Ascher, *supra* note 127, at 1599 ("The taxes on self-dealing more or less track, but substantially fortify, enforcement of state trust law concepts of the duty of loyalty.").

198. The legislative history of the enactment of the self-dealing excise tax expresses the desire of Congress "[t]o minimize the need to apply subjective arm's-length standards, to avoid the temptation to misuse private foundations for noncharitable purposes, to provide a more rational relationship between sanctions and improper acts, and to make it more practical to properly enforce the law." STAFF OF THE JOINT COMM. ON INTERNAL REVENUE TAXATION, 91ST CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1969, pt. III.A.2, at 30–31 (1970). In addition, Congress maintained "that the highest fiduciary standards require complete elimination of all self-dealing rather than arm's-length standards." *Id.* at 31.

The excise tax imposed on a distribution from a DAF to any natural person is also over-inclusive.[199] Forbidding distributions to individuals admittedly reduces the risk that a DAF will be misused to benefit the cronies of DAF insiders[200] without achieving charitable goals. However, the rule also forecloses the charitable act of aiding a person who is a member of a charitable class.[201] This over-inclusive regulatory excise tax provision prohibits charitable and noncharitable assistance alike.

A number of other regulatory excise tax provisions over-inclusively enforce the negative corollary of the charity advancement norm. Some are grossly over-inclusive, others less so. Several target conflict-of-interest transactions. Many have nothing to do specifically with the political activities of charities. A summary of these provisions appears in prior scholarship.[202]

3. Promotion of Norms of Care

The federal excise tax system governing charities does not comprehensively federalize the duty of care to the same degree that it imposes norms of obedience and loyalty, but in certain contexts it does incentivize competent or prudent fiduciary behavior. The greatest imposition of care norms occurs in the law taxing private foundations. A few examples suffice. First, and perhaps most obviously, a tax is generally imposed on both the entity[203] and management[204] if a private foundation "invests any amount in such a manner as to jeopardize the carrying out of any of its exempt purposes."[205] Under the Treasury regulations,

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199. *See* I.R.C. § 4966(a), (c)(1)(A).

200. A "DAF insider," as used in this Article, means a donor-advisor of a DAF and certain related persons specified by statute. DAF insiders include (1) any fund donor who has advisory privileges with respect to fund distributions or investments by virtue of her status as a donor; (2) the designee of any such donor; (3) a member of the family of any such donor or designee; and (4) any business entity in which the ownership interest of the foregoing exceeds thirty-five percent. *See id.* §§ 4958(f)(7)(A)–(C), 4966(d)(2)(A)(iii).

201. Notwithstanding the general rule, a special provision makes grants to an individual from a de facto DAF possible. Section 4966(d)(2)(B)(ii) excepts from the technical definition of a DAF a fund, with respect to which a fund donor offers advice, if the following conditions are satisfied: (1) Individual grantees receive grants only "for travel, study, or other similar purposes"; (2) the fund donor's advisory privileges are performed exclusively by her in her "capacity as a member of a committee[,] all of the members of which are appointed by the sponsoring organization"; (3) no combination of the fund's donors, their designees, and related persons directly or indirectly control the committee; and (4) all grants from the fund "are awarded on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the board of directors of the sponsoring organization, and such procedure is designed to ensure that all such grants meet the requirements of paragraph (1), (2), or (3) of section 4945(g)." *Id.* § 4966(d)(2)(B)(ii).

202. For a discussion, see Buckles, *Obedience Norms*, *supra* note 142, at 236–38.

203. *See* I.R.C. § 4944(a)(1).

204. *See id.* § 4944(a)(2).

205. *Id.* § 4944(a)(1).

> an investment shall be considered to jeopardize the carrying out of the exempt purposes . . . if it is determined that the foundation managers, in making such investment, have failed to exercise ordinary business care and prudence, under the facts and circumstances prevailing at the time of making the investment, in providing for the long- and short-term financial needs of the foundation to carry out its exempt purposes.[206]

The very standard itself is one of care.[207]

Secondly, if a private foundation makes a grant to certain types of organizations, it will incur excise tax under section 4945 unless it exercises "expenditure responsibility" with respect to the grant.[208] Generally, exercising expenditure responsibility means the private foundation

> exert[s] all reasonable efforts and . . . establish[es] adequate procedures—
>
> (1) to see that the grant is spent solely for the purpose for which made,
>
> (2) to obtain full and complete reports from the grantee on how the funds are spent, and
>
> (3) to make full and detailed reports with respect to such expenditures to the Secretary.[209]

This, too, is a limited imposition of modest norms of care or prudence.

Finally, private foundation managers can avoid liability for certain management-level excise taxes if their actions were based on "reasonable cause,"[210] which can be demonstrated by complying with norms of care.[211]

Fewer sections impose or incentivize adherence to care norms by fiduciaries of charities that are not private foundations. One instance in which care norms are incentivized is under section 4958. Disinterested managers of a charity are subject to excise tax only when they participate in an excess benefit transaction while "knowing that it is such," and they escape liability when their participation "is not willful and is due to reasonable cause."[212] A manager ordinarily does not participate "knowingly" in an excess benefit transaction if, after full disclosure to an appropriate professional, she relies

206. Treas. Reg. § 53.4944-1(a)(2)(i) (2019).

207. *See* Ascher, *supra* note 127, at 1602–03 (characterizing the section 4944 excise tax as "mimic[king] the state-law fiduciary duty to administer a charity in accordance with its terms and applicable law, the duty of care or prudence, and the duty to control and protect the charity's property").

208. *See* I.R.C. § 4945(d)(4)(B).

209. *Id.* § 4945(h).

210. *See, e.g.*, *id.* §§ 4941(a)(2), 4945(a)(2).

211. *See, e.g.*, Treas. Reg. § 53.4945-1(a)(2)(v).

212. I.R.C. § 4958(a)(2).

on a reasoned written opinion of the professional in approving the compensatory arrangement.[213] Appropriate professionals include legal counsel, certified public accountants, and qualified compensation consultants.[214] In addition, a manager ordinarily does not participate "knowingly" in an excess benefit transaction if the governing body of which she is a member has acted in a manner sufficient to invoke the rebuttable presumption of reasonableness, set forth in the Treasury regulations, applicable to conflicts-of-interest transactions between a charity and certain insiders.[215] Finally, a manager who does not know a compensatory arrangement is an excess benefit transaction does not act "willfully,"[216] and her participation is "due to reasonable cause," if she has acted "with ordinary business care and prudence."[217] These rules plainly encourage charity managers to exercise care in establishing the compensation of officers.

In addition, the excise taxes imposed on charity managers for an organization's political expenditures and lobbying expenditures by sections 4955 and 4912, respectively, are subject to "reasonable cause" exceptions.[218] Reasonable cause is determined by reference to norms of care.[219]

D. Limits and Bans on Lobbying and Electioneering

The Code curtails or limits the political activities of charitable entities through the fundamental exemption requirements and the federal excise tax system.[220] Courts and commentators have offered a number of rationales for these provisions.[221] Some of these rationales focus on the goal of preserving the integrity of democratic processes, often on the assumption that the perceived governmental subsidy that charities enjoy through federal income tax exemption and the receipt of tax-deductible donations would magnify charities' influence on politics.[222] But another rationale emerges from the analysis of the preceding two Sections of this Article[223]: The limitations on the political activities of charities prompt charity managers, albeit over-inclusively, to comply with basic norms of fiduciary behavior.

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213. Treas. Reg. § 53.4958-1(d)(4)(iii). Reliance on a professional is appropriate only if the professional is opining on a matter within her expertise. *See id.*

214. *See id.*

215. *See id.* § 53.4958-1(d)(4)(iv).

216. *Id.* § 53.4958-1(d)(5).

217. *Id.* § 53.4958-1(d)(6).

218. *See, e.g.*, I.R.C. §§ 4955(a)(2), 4912(b) (2012).

219. *See, e.g.*, Treas. Reg. § 53.4955-1(b)(6).

220. *See supra* Sections I.A and I.C.

221. For a survey of several rationales, see Buckles, *Not Even a Peep?*, *supra* note 10, at 1078–95.

222. *See, e.g.*, Tobin, *supra* note 10, at 1326–29 (arguing that lifting the ban on participating in political campaigns by churches would increase their political power).

223. *See supra* Sections III.B–C.

Consider the charity advancement norm and its negative corollary. Certainly, engaging in the political process may be an instrumental means to accomplish a charitable goal (as when an environmental charity lobbies for tougher laws restricting carbon emissions).[224] The Code implicitly recognizes this instrumentality by permitting modest attempts to influence legislation by charities other than private foundations. However, were a charity to operate primarily as a professional lobbyist, its managers would hardly be complying with the charity advancement norm and its negative corollary. By limiting the extent to which a charity can lobby and banning political campaign intervention altogether, the Code is imposing over-inclusive rules that promote adherence to the charity advancement norm and its negative corollary. Although these limitations on political activity do not ensure that an entity will fulfill charitable goals, they do impose "road-blocks" that prevent charities from going down certain noncharitable paths.[225]

One particular noncharitable path foreclosed by current tax law is to serve the private interests of political candidates and their constituents by financially supporting their political campaigns.[226] Theoretically, the ban on private inurement and the prohibition against excessive private benefit should dissuade charity managers from diverting significant resources to support political candidates in many situations. But establishing a violation of these restrictions, especially the private benefit doctrine, can be difficult as an evidentiary matter.[227] By imposing an outright ban on supporting or opposing candidates for public office, and by buttressing the prohibition with excise taxes, the Code further dissuades charity managers from breaching their duty of loyalty by intentionally furthering the private political interests of candidates and their supporters. Of course, conceptualized as a means to encourage compliance with the duty of loyalty, the ban on electioneering is both over-inclusive (because not all support of a political candidate implies a breach of the duty of loyalty)[228] and under-inclusive (because a breach of the duty of loyalty often occurs even without electioneering). This observation does not mean, however, that the limitations on political activity have no relationship to the other exemption requirements and excise tax provisions previously analyzed. Rather, it simply means that, like other features of the federal tax system governing charities, the Code's reinforcement of fiduciary

224. *See* Buckles, *Not Even a Peep?*, *supra* note 10, at 1090–92; Chisolm, *supra* note 10, at 345–46.

225. *Cf.* Colinvaux, *supra* note 10, at 703 (stating that, because of the prohibition on intervening in a political campaign, a charity "must focus on charitable not political purposes").

226. *See* Chisolm, *supra* note 10, at 342–44.

227. For a discussion of the private benefit doctrine, see *supra* note 30. The doctrine renders private benefit unlawful when the charity has substantially benefitted private interests, but not when the private benefits are merely "incidental." These imprecise standards do not readily lead to a finding of unlawful private benefit.

228. A charity could express support for a political candidate in hopes of obtaining results that benefit the charity (increased funding for education, for example, in the case of an inner-city school).

norms in the context of political activity is blunt and heavy-handed in some respects.

The point of this discussion is not to defend current law's limitations on political activity by charities. To the contrary, the Code goes too far by preventing all speech in support of, or in opposition to, candidates for public office.[229] Rather, the point is to advance the humble claim that the general federalization of norms of fiduciary behavior through current law's fundamental exemption requirements and excise tax provisions plausibly informs views of the tax system's regulation of the political activities of charities. Whatever other rationales might (or might not) justify current law's abridgment of the political activity of charitable organizations, surely the tax system's overall design of federalizing fiduciary norms must figure into an understanding of the restrictions on political activity by charities.

IV. THE FEDERAL TAX REGIME AND ITS POTENTIAL EXPLOITATION BY POLITICALLY MOTIVATED FOREIGN ACTORS

The preceding analysis raises serious questions of law and policy. Can foreign actors systematically use domestic charities to influence the political process in the United States, its policy, and its government officials? If so, how? Why does the design of our tax system permit this influence? Is this interference really problematic? What, if anything, should Congress do in response? In addressing these questions, this Part offers two purely descriptive claims, two descriptive-analytical claims, and eight normative-cautionary claims.

A. Current Law Does Not Prevent Foreign (or Domestic) Political Influence Through Domestic Charities

The first descriptive claim follows from applying the fundamental tax exemption requirements and the federal excise tax regime to the fact patterns presented in the case studies of Part II. Current tax law by no means precludes foreign influence on U.S. political processes through a foreign actor's engagement with domestic charities. Indeed, a number of potentially significant strategies for interacting with domestic charities in a way that promotes foreign political interests are permitted. Charities are, to some degree, "exploitable" by foreign actors for several reasons.

One reason is limited lobbying by public charities is generally permitted, regardless of the source of their donations.[230] The charity that is supported in part, even in large part, by foreign donors can lobby just as much

229. *See, e.g.*, Buckles, *A Reply*, *supra* note 10; Buckles, *Not Even a Peep?*, *supra* note 10.

230. *See* I.R.C. § 501(c)(3) (2012) (permitting a section 501(c)(3) organization to engage in attempts to influence legislation that do not constitute a "substantial part" of the organization's activities).

as the charity supported exclusively by U.S. citizens. And no tax law prohibits donations from foreign governmental bodies, let alone foreign individuals who may or may not be aligned politically with a foreign government. Although grants from a foreign government are not entirely counted as "indirect contributions from the general public" for purposes of calculating a public charity's sources of public support,[231] the grants are nonetheless acceptable gifts. The ability to attract repeated, large donations through an SO that lobbies magnifies the potential influence of large foreign donors.[232] Because an SO need not be broadly supported by the general public, a public charity could create a section 509(a)(3) SO extensively funded by foreign actors, even a foreign government. Foreign donors can also have a significant voice in the management of such an SO, as long as a disqualified person does not control the SO.[233]

Another reason foreign actors can leverage their donations to affect policy is charities are free to influence executive officials and administrative agencies; such activities generally are not considered lobbying.[234] Accordingly, private foundations, unaffiliated public charities, and SOs can all try mightily to influence a presidential administration's executive action. The same is true of administrative action. Given the expansive role of rulemaking by agencies in the modern administrative state,[235] and the very broad delegation of rule-making authority that the Supreme Court has vested in Congress under its interpretation of the Constitution,[236] the potential impact of charitable organizations on the making of U.S. administrative law is great. Neither the fundamental exemption requirements nor the federal excise tax system limits this legal power of charities supported by foreign actors, including foreign governments.

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231. *See id.* § 170(b)(1)(A)(vi); Treas. Reg. § 1.170A-9(f)(1)(ii) (2019).

232. *See, e.g.*, *supra* Part II (*Case 5* and *Case 8*).

233. *See* I.R.C. § 509(a)(3)(C).

234. *See* Treas. Reg. § 56.4911-2(d)(3). The excise tax regulations defining "taxable expenditure" in the case of attempts by a private foundation to influence legislation generally incorporate the definitions of Treasury regulation section 56.4911-2. *See* Treas. Reg. § 53.4945-2(a)(1). Under the Treasury regulations, a "direct lobbying communication" includes "any attempt to influence any legislation through communication with . . . [a]ny government official or employee . . . who may participate in the formulation of the legislation, but only if the principal purpose of the communication is to influence legislation." Treas. Reg. § 56.4911-2(b)(1)(i)(B). Communication with a government official satisfies this definition "if, but only if, the communication . . . [r]efers to specific legislation . . . and . . . [r]eflects a view on such legislation." Treas. Reg. § 56.4911-2(b)(1)(ii)(A)–(B). Thus, a charity may communicate freely with executive officials on policy matters without running afoul of the lobbying limitations simply by not expressing a viewpoint on specific legislation.

235. *See* Anne Joseph O'Connell, *Political Cycles of Rulemaking: An Empirical Portrait of the Modern Administrative State*, 94 VA. L. REV. 889, 892 (2008) ("The federal administrative state does more lawmaking, by some measures, than Congress.").

236. The Court has interpreted the Constitution to permit broad delegations by Congress of the power to make law. *See, e.g.*, Mistretta v. United States, 488 U.S. 361, 371–79 (1989).

A third reason foreign actors can leverage their financial support of charities to influence political actors is some charities are either managed or supported by people with prominent positions in political networks.[237] Such charities, at least those large enough to hire legal counsel, are probably not so unsophisticated as to promise political favors for donations in a quid pro quo exchange. But such charities are still free, informally and non-contractually, to curry continued favor with large donors, including foreign donors, by urging political actors to behave in ways that please those donors. Although some risk of running afoul of the private inurement or private benefit doctrine exists if charity officers or employees, acting in their capacity as such, seek political favors for large donors in a way that does not further the charity's exempt purposes, it is doubtful these fundamental exemption requirements are violated when charity agents facilitate political favors for donors "on their own time."[238] The surest way to prevent attribution of such activity to the organization itself is for the charity to adopt and enforce a policy prohibiting its officers and employees from using the organization's resources (including employee time) for these purposes. The charity should also require an employee that approaches political actors to communicate to the relevant donors and political actors that the employee is acting other than as an agent or representative of the charity, and to document that the employee so communicated. If the charity takes these measures, the political favors extended by those affiliated with the charity would not likely be attributed to the charitable entity.

My second descriptive claim is a more generalized version of the first. What was said in the first claim about foreign actors also applies broadly to all donors. That is, current tax law provides a number of potentially significant strategies for interacting with charities in a way that promotes a donor's political interests. Charities are, to some degree, "exploitable" by domestic, as well as foreign, donors. The potential for using charities under the strategies described above is not foreclosed by the prohibition against political campaign intervention by all charities,[239] the excise tax on political expenditures of charities generally[240] and private foundations specifically,[241] the general limitations on lobbying,[242] or the federal excise taxes on (certain) lobbying expenditures of public charities[243] and lobbying expenditures of private foundations.[244]

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237. *See supra* note 9 and accompanying text.
238. For a discussion, see *supra* Part II (analysis of *Case 6*).
239. *See* I.R.C. § 501(c)(3) (2012).
240. *See id.* § 4955.
241. *See id.* § 4945(a), (d)(2).
242. *See id.* § 501(c)(3), (h).
243. *See id.* §§ 4911–12.
244. *See id.* § 4945(a), (d)(1), (e)(1)–(2).

B. Advancement of Charities May Coincide with the Advancement of Donors

Why is the basic structure of federal charity taxation subject to this potential for exploitation? The answer is supplied by my first descriptive-analytical claim: The federal tax regime is largely designed to encourage adherence to basic norms of fiduciary behavior, and these norms do not guard against the prospect that the advancement of charity may coincide with the political interests of foreign actors. Federal tax law most prominently reinforces the charity advancement norm and its negative corollary.[245] Some tax provisions can be understood more specifically as federalizing the duty of loyalty,[246] and a few can be conceptualized as imposing a federalized duty of care.[247] Although no tax provisions appear to enforce a notion of static charter fidelity or historic mission fidelity, some do reinforce or require at least dynamic charter fidelity.[248] A supra-legality norm is also imposed under judicial and administrative interpretations of the fundamental requirements for federal income tax exemption.[249] But most recognizable are the numerous tax provisions that compel charity managers to advance *charitable* (or other exempt) purposes and prohibit them from advancing non-charitable purposes. These provisions, in other words, impose upon fiduciaries the charity advancement norm and its negative corollary.

So understood, it is not surprising that the federal system of taxing charities does not seek to limit foreign support of domestic charities generally, or foreign support of charities coupled with political motives, specifically. Charity has no borders.[250] Just as domestic organizations such as World Vision and Samaritan's Purse advance charitable purposes when they feed starving Sudanese children or provide medical care and blankets to Syrian refugees in Turkey, so do U.S. environmental and educational organizations operating domestically advance charitable purposes when they fulfill their missions in part by deploying donations from Saudi princes and Russian oligarchs. Moreover, in general, under federal tax law, charity is a function of

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245. *See supra Sections* III.B–III.C.2. Professor Mark Ascher has concluded similarly:

> What all these requirements—the operational test, the ban on private inurement, the rules relating to campaign involvement and lobbying, the commerciality doctrine, and the "commensurate in scope" standard—have in common is an insistence at the federal level, often lacking at the state level, that a charity behave like a charity. Nor is there the slightest doubt that the threat of IRS scrutiny often affects the behavior of those who operate charities.

Ascher, *supra* note 127, at 1596.

246. *See, e.g.*, I.R.C. §§ 4941, 4958.

247. *See, e.g.*, *id.* § 4944.

248. *See supra* note 156.

249. *See supra* Section III.B.3.

250. *Cf.* Harvey P. Dale, *Foreign Charities*, 48 TAX L. 655, 662 (1995) ("[I]n pursuit of its mission, a domestic charity can properly make charitable gifts to a foreign charity.").

institutional purpose and activity,[251] not donors' motives and incidental and indirect effects of plainly charitable operations. For example, an environmental and educational organization might succeed in educating the public about the efficiency of renewable energy sources to such a degree that demand for fossil fuels plummets and the current administration completely alters its agenda for solar, wind, and hydro power. In those circumstances, the political motives of foreign donors and the incidental consequences that benefit them are irrelevant to the question of whether the organization's activities are "charitable."[252]

A second and related descriptive-analytical claim naturally accompanies the first. The federal tax regime's reinforcement of basic norms of fiduciary behavior does not tightly guard against the prospect that the advancement of charity may coincide with the political, financial, or social interests of *any* donor, foreign or domestic. To support a certain college, for example, in hopes that it will produce a more politically progressive or politically conservative populace does not cause the college to be any less educational. To support a local mosque while praying that its expanded neighborhood outreach will make community members more tolerant of a welcoming immigration policy does not render the mosque any less religious. To support crisis pregnancy centers while dreaming that their mission will influence the public to disfavor government funding of abortions or spur an increase in sales of baby formula and diapers, does not make the centers' operations any less charitable. The same is true if the desired consequences of supporting the charities ensue (i.e., the populace becomes more progressive or conservative, immigration policy becomes more welcoming, and a greater number of formula-guzzling and diaper-wetting babies are born). The basic norms governing charity fiduciary behavior simply do not require charity managers to probe a donor's mere motives or to speculate as to the tangential consequences of successful charitable operations. Because the fundamental federal income tax exemption requirements and federal excise tax regime are principally concerned with reinforcing these basic fiduciary norms, they understandably do not require fiduciaries to become mind readers or prophets.

C. Normative Claims and Recommendations

Having advanced the two purely descriptive claims and the two descriptive-analytical claims, this Article turns to its normative-cautionary claims.

251. *See* Treas. Reg. § 1.501(c)(3)-1(a)(1) (2019) ("In order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section.").

252. This observation holds unless an entity runs afoul of the private benefit doctrine. For a discussion of the private benefit doctrine, see *supra* note 30 and accompanying text.

1. Reexamining the Influence of Charities on the Executive Branch

The first claim is that current tax law's substantial restrictions on lobbying by charities and the law's severe constraints on political campaign-related speech by charities should be re-examined, for they are difficult to reconcile with the virtually unlimited degree to which charities can attempt to influence executive action and administrative lawmaking. The executive branch wields significant power in setting federal policy.[253] That charities are prohibited from having even a modest voice in electing our President[254] is rather puzzling when the same charities, post-election, are mostly free to influence the elected President on matters of policy that concern the charity. Similarly, it seems anomalous that charities are quite limited in their ability to attempt to influence the formulation of laws by Congress[255] but are quite free to attempt to influence the formulation of laws by administrative agencies. This asymmetry is especially noteworthy in a world in which Congress has delegated vast rule-making power to agencies.[256]

Tax laws permitting charities to attempt to influence the President and agencies may be justifiable. Indeed, core First Amendment norms are in great tension with the political activity restrictions of section 501(c)(3).[257] The main point for present purposes, however, is that the disparate treatment of executive petitioning, on the one hand, and lobbying and electioneering efforts, on the other, is peculiar and begs a thorough evaluation.[258] A number of possible justifications for allowing extensive executive petitioning may exist—in addition to the rather obvious need to respect the constitutional right to petition government. Perhaps the risk that private, for-profit industry will capture the administrative agencies that regulate them is mitigated if charity watchdogs can freely interact with the same agencies. Perhaps the stifling effect of the electioneering ban on the political voice of charities is

253. *See, e.g.*, Steven G. Calabresi & Saikrishna B. Prakash, *The President's Power to Execute the Laws*, 104 YALE L.J. 541, 549–50 (1994) (arguing for a unitary executive interpretation of the Constitution on originalist grounds); Martin S. Flaherty, *The Most Dangerous Branch*, 105 YALE. L.J. 1725, 1727 (1996) ("Never has the executive branch been more powerful, nor more dominant over its two counterparts, than since the New Deal.").

254. *See* I.R.C. § 501(c)(3) (2012) (prohibiting a tax-exempt charity from participating in a political campaign on behalf of a candidate for public office).

255. *See id.* (stating that "no substantial part" of a tax-exempt charity's activities may consist of attempting to influence legislation).

256. *See* Thomas W. Merrill, *Rethinking Article I, Section 1: From Nondelegation to Exclusive Delegation*, 104 COLUM. L. REV. 2097, 2099 (2004) ("Congress has massively delegated legislative rulemaking authority to administrative agencies.").

257. *See* PHILIP HAMBURGER, LIBERAL SUPPRESSION: SECTION 501(C)(3) AND THE TAXATION OF SPEECH 190–213 (2018); Chisolm, *supra* note 10, at 319–20; Leff, *supra* note 10, at 685–96; Johnny Rex Buckles, *The Penalty of Liberty*, 25 TEX. REV. L. & POL. (forthcoming 2020).

258. Taxable persons must treat political expenditures more consistently. Taxpayers who normally deduct business expenses are foreclosed from deducting payments related to influencing legislation, intervening in a political campaign, and communicating with certain executive branch officials. *See* I.R.C. § 162(e)(1)–(5).

somewhat ameliorated by lenient rules governing attempts to influence elected Presidents. Similarly, perhaps the limits on the ability of charities to influence legislation, which weaken the political voice of the charitable sector, are properly offset by laws that permit extensive influence of administrative rulemaking and other administrative action by charities, thereby giving charities a more meaningful seat at the policy table.

However, such a desire for "balance" does not necessarily justify existing law. If empowering the political voice of the charitable sector is thought desirable in view of the electioneering ban and the limitations on lobbying, perhaps the better approach is to loosen the restrictions currently imposed by section 501(c)(3) and impose modest, constitutionally compliant limitations on the ability of charities to influence executive officers and administrative agencies.[259] That charities affiliated with members of powerful political networks likely have much greater influence over executive officials and high-ranking administrative staffers than do less politically connected organizations is cause for concern. A regime that imposes strict limitations on lobbying and prohibits political campaign intervention but hardly restricts influencing the executive branch may simply magnify the power and influence of politically connected charities relative to that of charities that lack political "insider" status.

2. Addressing the Potential, Stealthy Influence of Large Donors

A second normative-cautionary claim is that current tax law may encourage the exercise of political influence in the charitable sector stealthily, and assessing and (if necessary) responding to this problem should be a policy priority. Consider two of the strategies that emerge from the hypothetical case studies. First, a public charity can use an SO to engage in lobbying and other forms of influence over law and policy.[260] By creating an SO that lobbies, a charity can attract repeated gifts from a single large donor. Doing so does not jeopardize the public charity classification of the charity supported by the SO. Such a donor may well be able to shape the SO's activities in a way that the donor would be unable to accomplish through the supported charity (because, for example, the bulk of repeated large gifts would not count as public support, and the charity would eventually decline large gifts from that donor to avoid private foundation classification). As an example, such a donor may be able to influence the SO to make the section 501(h)

259. Current law probably does not strike the ideal balance between safeguarding the political process and permitting charities to have a meaningful political voice. Current law essentially treats each of the following differently: lobbying (permitted in moderation), political campaigning (prohibited), and influencing executive and administrative action (mostly unchecked, although the fundamental exemption requirements preclude certain types of egregious abuses). It is difficult to justify these disparities as entirely coherent.

260. *See supra* Part II (*Case 5* and *Case 8*).

election and engage in more extensive legislative activities than the supported charity, standing alone, would choose to do. Similarly, the SO may engage in far greater efforts to influence executive officials and administrative agencies than the supported charity, standing alone, would undertake. The supported charity may nonetheless be willing to cooperate with the formation of the SO because it generously supports the primary operations of the supported charity.

The other strategy of concern is the exploitation of a charity's network of influence by large, powerful donors. Existing law does not appear to guard against this tactic well, at least when a charity is sufficiently advised not to employ the charity's resources directly to peddle influence and not to engage in a quid pro quo exchange. Moreover, the potential for this exploitation seems real.[261] Large donors do not necessarily compensate the charity for amassing a staff of the politically connected, but their donations effectively "pay" for introductions to the politically connected charitable staff.

Although the law could attribute all of the activities of charity officers to the entity when the officers secure a political favor for a large donor, this attribution would raise real liberty concerns. The law does not treat a pastor as always speaking for the church or a university president as always representing the university.[262] Otherwise, pastors and university presidents could never endorse or oppose presidential candidates. To restrict pastors and university presidents in this way would impose harsh restrictions on the exercise of their fundamental freedoms.[263] Perhaps the law would not necessarily restrict the freedom of charity officers objectionably by presumptively treating an officer's actions for the charity's donor as one performed on behalf of the charitable entity. But some restrictions do seem excessive. What if the donor is a long-standing friend of the officer who knew the donor from childhood? What if the donor is related to the officer? What if the donor and officer have become good friends through working to achieve mutual charitable goals over time? In such situations, invariably attributing the personal political favors secured by the officer to the charity seems to ignore the overwhelmingly personal reasons for the officer's behavior. Further attention should be devoted to ascertaining how the tax laws should handle this type of potential exploitation of the political clout of a charity's staff.

3. *Reconsidering the Territorial Limits of Charity*

The third normative-cautionary claim is that the "territorial" limits of charity for purposes of federal taxation, and the law of charity in general,

261. *See supra* Part II (*Case 6*).

262. *See* Rev. Rul. 2007-41, 2007-1 C.B. 1421.

263. *Cf.* McDaniel v. Paty, 435 U.S. 618, 621, 629 (1978) (plurality opinion) (holding that a state statute disqualifying clergy from serving as delegates to a state constitutional convention violated a minister's First Amendment right to the free exercise of religion).

should be carefully contemplated. Charity knows no borders, and for many purposes of tax law, accomplishing charitable purposes outside the geographical boundaries of the United States is entirely appropriate for a domestic charitable organization.[264] U.S. charities are free to conduct charitable work overseas, and they can even make grants to foreign charitable entities.[265] But there are limits to this borderless concept of charity under U.S. tax law. For example, a donation to a "trust, chest, fund, or foundation" by a corporation is deductible[266] in computing the corporation's taxable income only if the gift "is to be used within the United States or any of its possessions."[267] Further, a donation to a charitable entity entitles a donor to claim a charitable contributions deduction only if the recipient is "created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States."[268] Presumably the justification for this latter requirement is to ensure that donations are actually used for charitable purposes, and the risk of misappropriation is too great when the only charities using or monitoring donations are not subject to U.S. laws and governmental oversight of those laws.[269] This is a destination-based territorial concern (albeit, a debatable one).[270]

But perhaps a source-based territorial concern also exists. Charitable entities have been conceptualized in academic commentary as qualified "co-sovereigns" with the state[271] or as "agents of the community" that serve community purposes alongside governments.[272] Under the sovereignty concept, the federal government is quite obviously the supreme constitutional sovereign of the United States, but it recognizes the limited co-sovereignty of charitable entities for some purposes of law (such as by generally exempting them from federal income taxation).[273] Domestic charities that significantly serve

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264. *See, e.g.*, Rev. Rul. 75-65, 1975-1 C.B. 79 (ruling that contributions to a domestic charitable organization formed to foster plant and wildlife ecology in a foreign country are deductible).

265. Private foundations avoid federal excise tax for making grants to a foreign charity by ensuring that the foreign charity meets the general requirements for domestic public charities. *See* Treas. Reg. §§ 53.4942(a)-3(a)(6)(i)–(ii), 53.4945(a)-5(a)(5)(i)–(ii) (2019).

266. *See* I.R.C. § 170(a), (c)(2) (2012).

267. *Id.* § 170(c)(2). The IRS has ruled that this language does not preclude the deductibility of contributions by a corporation to a domestic charitable *corporation* that uses its donated funds for a charitable purpose in a foreign country. *See* Rev. Rul. 69-80, 1969-1 C.B. 65.

268. I.R.C. § 170(c)(2)(A).

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

270. For a critique of, and discussion of alternatives to, the requirement that a charitable donation be organized in the United States, see David E. Pozen, *Remapping the Charitable Deduction*, 39 CONN. L. REV. 531, 593–94 (2006).

271. *See, e.g.*, Evelyn Brody, *Of Sovereignty and Subsidy: Conceptualizing the Charity Tax Exemption*, 23 J. CORP. L. 585, 585–96 (1998).

272. *See* Johnny Rex Buckles, *The Community Income Theory of the Charitable Contributions Deduction*, 80 IND. L.J. 947, 977–79 (2005).

273. *See* Brody, *supra* note 271, at 588–89.

the interests of major foreign donors, especially foreign governments, may lie outside the intended sovereignty conception of the charitable sector, at least in some cases. The federal government has expressed alarm over foreign influence on U.S. democratic processes.[274] When a foreign government uses a domestic charity to influence our political process, directly or indirectly, one sovereign (the foreign government) is in some respects acting with or through the operations of the charitable co-sovereign. Although the federal government has assigned a legitimate operational/jurisdictional sphere for charitable co-sovereigns, the government has not intentionally granted foreign sovereigns the privilege of acting within the same sphere. In other words, the exploitation of charities by foreign governments may be conceptualized as a usurpation, or at least infringement upon, the exclusive, limited co-sovereignty of charitable organizations recognized by the federal government.

Similarly, under the community agency concept, both the federal government and domestic charities exist as agents for the benefit of their principal—the community at large (or, perhaps in the case of the government, the community comprising U.S. citizens and residents).[275] Domestic charities that substantially serve the interests of major foreign donors, and foreign governments in particular, may be understood as acting beyond the scope of their agency. Any foreign government that acts to influence U.S. democratic processes directly may naturally be perceived by the federal government as a subversive agent. Democracy is about the members of the American citizenry, one community, exercising self-determination, not the determination of a foreign power. Further, a foreign government will often conceive of the "community" that functions as its principal differently from how the U.S. government understands its community/principal. When a foreign government, or foreign individuals aligned with a foreign government's interests, exploit domestic charities to influence U.S. political processes, the charities may be viewed as no longer exclusively serving their principal (the community at large, or perhaps that segment of the community consisting of the U.S. citizenry). Instead, they may be viewed as serving the narrower, and perhaps inconsistent, interests of a subversive agent, at least in part.

These theoretical conceptions of the charitable sector hardly lead to definitive answers to the questions of whether, when, and how the law should treat support from foreign sources differently from domestic support, or charities funded by foreign donors (especially governments) differently from those entirely domestically supported. Current tax law generally does not directly limit the political activity of charities based on the source of their donations. But to some degree it does so indirectly. Private foundations are

274. *See supra* note 3 and accompanying text.
275. *See* Buckles, *supra* note 272, at 977–79.

so classified because of their failure to receive broad public support,[276] and private foundations are generally prohibited from lobbying (because of the federal excise tax on taxable expenditures),[277] as well as influencing electoral politics.[278] In contrast, other charities can engage in limited lobbying.[279] The concern in the case of private foundations is apparently that a dominating founder could use the foundation to lobby inappropriately.[280] By analogy, perhaps certain types of domestic charities are especially susceptible to the domination of large foreign donors, including foreign governments. Such charities likely include SOs, and perhaps unaffiliated public charities that rely extensively on the support of foreign donors (including those that maintain DAFs). If so, it is appropriate to ponder whether the tax system should guard against this type of domination, and if so, how it should do so.

4. Varying Regulation of Different Kinds of Foreign Support

The fourth normative-cautionary claim is that not all foreign influence is equally concerning, and therefore, the law probably should not regulate all foreign support the same, or all charities that receive foreign support the same. Support received directly or indirectly from a foreign power is likely often politically motivated, for a foreign power is a political actor. But even a foreign power, for largely charitable reasons, may prefer a U.S. charity operating globally to a charity located in a third country; for example, perhaps the government desires to circumvent the political corruption faced by charities domiciled in the third country. Donations from foreign individuals might or might not be suspect. Those who are not political insiders or conduits of foreign governments are less likely to be politically motivated. But herein resides a difficulty. Lawmakers should not naively assume that all donations ostensibly received from individual donors lack ultimate sourcing in a federal government. If a charity receives donations from individuals who are citizens or residents of an autocratic nation, it is plausible that, at a minimum, the foreign government in which the donors reside not only is aware of the donations, but is also probably complicit in them; otherwise, it would be strange that the autocracy permitted the donations. The more autocratic and technologically sophisticated the nation is, the stronger these inferences

276. *See* I.R.C. § 509(a) (2012).

277. *See id.* § 4945(a)(1), (d)(1).

278. *See id.* § 4945(a)(1), (d)(2). Of course, participation in a political campaign is also prohibited by the basic exemption requirements governing all charities. *See id.* § 501(c)(3).

279. *See id.* § 501(c)(3) (permitting an insubstantial part of a charity's activities to consist of lobbying).

280. The legislative history of the Tax Reform Act of 1969, by which Congress enacted the private foundation excise tax regime, indicates congressional concern that large private foundations could engage in more lobbying than smaller foundations under the "substantiality" test governing legislative activities under section 501(c)(3). *See* STAFF OF THE JOINT COMM. ON INTERNAL REVENUE TAXATION, 91ST CONG., *supra* note 198, pt. III.A.6, at 47.

become. Further, when the autocracy itself is known to have interfered with U.S. politics and policy, donors who are citizens of that government may be but pawns in the hands of the foreign power (i.e., "fronts" for the foreign government). These observations caution against blithely assuming that donations that appear to have been made by individuals do not arise from the war chest of a foreign government.

One should also acknowledge that not all forms of influence are equally troubling. Direct support of a plainly charitable activity (like promoting cleaner energy consumption through public education) is less concerning than, for example, the peddling of back-room influence over senior cabinet officials. Activities that are undertaken by a charity openly can be observed, evaluated, and addressed by those with competing notions of the good. But clandestine meetings behind closed doors cannot be readily countered. In cases in which foreign persons are funding the former type of charitable activity, if further regulation is thought necessary, perhaps it should take the form of enhanced donor disclosures. However, direct regulation of the latter type of activity may well be warranted.[281]

5. Recognizing the Benefits of Foreign Support

The fifth normative-cautionary claim is that U.S. policymakers should continue to recognize the legitimacy and benefits of many sources of foreign support enjoyed by U.S. charitable organizations. We must not slip into a twenty-first-century philanthropic McCarthyism. Just as foreign charitable work financed by U.S. citizens is often (and usually) laudable, so also is domestic charitable work financed by citizens abroad. When a specific charitable activity, such as providing higher education, of a domestic organization merits its exemption from federal income taxation, the activity does not become suspect just because foreign individuals support it. To the contrary, that nonresidents support the activity may, in some circumstances, provide evidence that the activity is especially meritorious. Such would be the case when remote donors are unlikely to reap substantial secondary benefits from the activities of a U.S. charity, as when a U.S. charity's services are provided only domestically or in other regions of the globe not including a foreign donor's domicile.

As the hypothetical case studies illustrate,[282] some foreign donors to U.S. charities may be motivated in part by self-interest. But the same is true of U.S. donors. One may donate to a local volunteer fire department, for

281. Relevant principles appear in guidance for determining whether a charitable transfer overseas violates the Foreign Corrupt Practices Act, 15 U.S.C. §§ 78dd-1–78dd-3. *See generally* U.S. DEP'T OF JUSTICE & U.S. SEC. & EXCH. COMM'N, A RESOURCE GUIDE TO THE U.S. FOREIGN CORRUPT PRACTICES ACT 16–19 (2012), https://www.sec.gov/spotlight/fcpa/fcpa-resource-guide.pdf.

282. *See supra* Part II.

example, to help ensure protection of one's own property.[283] When a charity's services are broadly distributed to the general public, this marginal and incidental benefit enjoyed by donors is consistent with the underlying charitable nature of the organization's operations. The same is no less true when foreign donors enjoy the same broadly distributed benefits. Even when a foreign donor stands to benefit more than simply as a member of the public at large, as in several of the hypothetical case studies,[284] it is not clear that the charity should be disqualified from federal income tax exemption on this ground alone. A domestic donor may similarly benefit from a charity's operations, as when the owner of a solar energy company makes unrestricted charitable contributions to environmental charities with political connections. The point is, if one is concerned that certain gifts by foreign donors may benefit them disproportionately, but not to the point of running afoul of the private benefit doctrine,[285] one likewise should be concerned with gifts by similarly situated domestic taxpayers.

6. Recognizing Harmful Foreign Support to Domestic Charities

The sixth normative-cautionary claim is that policymakers should recognize one type of foreign support of domestic charities that presents special concerns: support used to shape domestic policies to achieve a charitable goal requiring international cooperation that is absent, when the absence of international cooperation enables the same foreign donors to *undermine or neutralize* the achievement of charitable goals ostensibly advanced by the foreign donation. An example of this phenomenon appears in *Case* 1,[286] in which the Russian oil baron's motive for supporting an environmental charity is to increase domestic regulation of the oil and gas industry and thereby confer a competitive market advantage on the donor overseas. Essentially the same concern exists if the donor is a Saudi prince or the government of Iran.

More equivocal international dynamics may also be in play. Consider a wealthy member of the Alternative for Germany party who, unhappy with the perceived link between crime and the number of young, male refugees who have relocated to Germany,[287] supports a politically connected U.S. human rights charity seeking to increase the migration of young, male refugees to the United States. Providing a stable environment for refugees is surely

283. *See, e.g.*, Rev. Rul. 74-361, 1974-2 C.B. 159 (ruling that a volunteer fire company providing fire protection and ambulance services to a community qualifies for federal income tax exemption as a charitable organization under section 501(c)(3) and that contributions made to it are deductible under section 170).

284. *See supra* Part II.

285. *See supra* note 30 and accompanying text.

286. *See supra* Part II.

287. *See, e.g.*, Reality Check Team, *Reality Check: Are Migrants Driving Crime in Germany?*, BBC NEWS (Sept. 13, 2018), https://www.bbc.com/news/world-europe-45419466.

charitable.[288] But in this example, whether the United States provides better asylum than Germany is unclear, and the wealthy donor is acting in his perceived self-interest.

These examples illustrate that international charity dynamics raise complex issues. Domestic charitable activity is intertwined not only with domestic public policy, but also with American foreign policy. Such complex dynamics surely require a regulatory regime that reflects sophistication and administrators who have expertise in a variety of fields.

7. Mounting a Response Beyond the Public Policy Doctrine

The seventh normative-cautionary claim is addressed primarily to judges, IRS agents, and academic analysts: The public policy doctrine of *Bob Jones University v. United States* should not be viewed as adequate to respond to politically motivated foreign influence on domestic tax-exempt charities.[289] One can imagine a revenue agent or a court grappling with whether to apply the doctrine when foreign donors have objectives that conflict with the policy prerogatives of a presidential administration. For example, consider a domestic human rights organization that provides free legal counsel to asylum seekers. Employing the strategy illustrated in *Case 5*,[290] a handful of Central American aristocrats form a section 509(a)(3) SO to support the human rights charity. With the approval of the supported organization, the SO lawfully mounts a lobbying campaign designed to expand the grounds for seeking asylum and to raise legislative support for providing greater federal resources to asylum seekers. Assume the lobbying campaign is successful, and that new, more liberal legislation for asylum seekers results in expanded migration to the United States from Central America. But the heightened migration places additional demands on border security patrols to such a degree that the President declares a national emergency to address the border crisis.

The IRS then toys with whether the SO and its supported organization have violated "established public policy"[291] by severely undermining the ability of the federal government to enforce the U.S.-Mexico border. The IRS might consider applying the public policy doctrine to these facts because the doctrine is vague[292] and, by its terms, not limited to situations in which a

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288. Relief of the distressed is a charitable purpose. *See* Treas. Reg. § 1.501(c)(3)-1(d)(2) (2019).

289. 461 U.S. 574 (1983); *see also supra* notes 45–49 and accompanying text.

290. *See supra* Part II.

291. *Bob Jones Univ.*, 461 U.S. at 591, 595–96.

292. *See* Buckles, *Law Schools*, *supra* note 49, at 27–35; Buckles, *Reforming*, *supra* note 49, at 407–37; Buckles, *Religious Schools*, *supra* note 49, at 276–78. For an illustration of the malleability of the public policy doctrine in the form of several hypothetical judicial opinions on whether Yale University should lose its federal income tax exemption, see Buckles, *Law Schools*, *supra* note 49, at 4–44.

charity is acting unlawfully.[293] Further, the indirect effect of the SO's lobbying campaign is to burden border enforcement. But border enforcement is clearly part of current U.S. federal public policy.

Applying the public policy doctrine here is suspect. First, that a charity's achievement of its goals might modestly add to the burdens of government is hardly grounds for disqualifying the charity from tax exemption. Although lessening the burdens of government is a charitable purpose,[294] not all charitable activities relieve governmental burdens. For example, an organization that successfully works to reduce infant mortality will eventually place a greater burden on public schools, but that happy result does not disqualify the charity from exemption. Moreover, the hypothetical SO was availing itself of one of the tools of democracy (public persuasion), not usurping democratic processes. Further, and relatedly, the SO's activity (free speech) enjoys constitutional protection (the First Amendment), a fact that counsels against finding a violation of public policy in many cases.[295] Finally, the actions of the foreign donors were remote links in the chain of events leading to the border crisis. The decision to enact the pro-asylum legislation was that of elected officials, and the choice to storm the border was made by immigrants, not the SO.

Admittedly, with a little imagination one can conjure up scenarios in which the public policy doctrine might be a better fit for challenging a charitable organization's federal income tax exemption. But the mere presence of foreign influence over a politically impactful charity is not alone sufficient to apply the doctrine. Further, the vagueness of the public policy doctrine hardly provides charities with adequate notice of when they would offend the doctrine.[296] Additionally, the IRS is not equipped to judge which of the innumerable yet legal forms of foreign influence on domestic charities are sufficiently objectionable to contravene established public policy. Legal tools more precise than the public policy doctrine are necessary to address concerns that foreign donors are lawfully but inappropriately influencing U.S. policies and processes through interactions with domestic charities.

8. Looking Outside the Tax System

The eighth normative-cautionary claim follows from the sixth and seventh normative-cautionary claims: The tax system cannot adequately serve as the exclusive legal regime for addressing all legitimate concerns raised by

293. *See Bob Jones Univ.*, 461 U.S. at 591 ("A corollary to the public benefit principle is the requirement, long recognized in the law of trusts, that the purpose of a charitable trust may not be illegal or violate established public policy.").

294. Treas. Reg. § 1.501(c)(3)-1(d)(2) (2019).

295. *See* Buckles, *Reforming*, *supra* note 49, at 475–77.

296. *See* Buckles, *Religious Schools*, *supra* note 49, at 276–78.

foreign actors' use of tax-exempt charities to influence U.S. democratic processes, policy, and political actors. Certain potentially troubling issues raised in this Article may indeed require reforming portions of the Code. For example, perhaps charities should be required to disclose the size of donations received from foreign sources and the identity of foreign donors on their annual information returns.[297] Such disclosures would enable the public to evaluate the operations of a foreign-supported charity in a better light. Perhaps the Code should restrict the amount of support tax-exempt charities can receive directly from foreign governments, which presumably are often politically motivated in their grantmaking.[298] Also worth considering is more strictly constraining the political activities of section 509(a)(3) SOs and organizations that maintain DAFs.

But nuanced regulation of foreign donations intended to influence U.S. politics may require administration by an agency other than, or in addition to, the IRS. The expertise of the IRS is in revenue collection and in administering a statute intended to raise revenue. Although the IRS has long regulated charities through the tax system, for the reasons explained previously, the existing regulatory tax regime largely reinforces fundamental norms governing fiduciary behavior.[299] The IRS has extensive experience in reinforcing these fiduciary norms, but no expertise in administering a system focused on foreign influence on U.S. democratic processes. Further, IRS resources are already stretched thin.[300] Funding an agency focused on combatting foreign influence on our democracy would likely garner more bipartisan support than increasing appropriations for the IRS. Moreover, there may be some synergistic benefits of tasking two or more federal agencies with addressing different aspects of the problem of foreign influence on our political processes and government officials. Thus, although the IRS should likely serve a role in responding to these foreign threats, the IRS probably should share this responsibility, even the greater responsibility, with other agencies specifically equipped to deal with problems involving foreign donors.

297. *See, e.g.*, Uncovering Foreign Influence in the United States Act of 2019, H.R. 703, 116th Cong. (2019).

298. Entirely prohibiting the receipt of contributions from a foreign government is also an option, but one that seems quite severe when it is appreciated that primarily charitable motives may sometimes explain why a foreign government determines to support a U.S. charity, rather than a charity in some other country.

299. *See supra* Sections III.B–III.C.

300. *See IRS Underfunded to Serve Taxpayers, Collect Tax*, TAXPAYER ADVOC. SERV., https://taxpayeradvocate.irs.gov/2012-Annual-Report/irs-funding.html (last visited Apr. 15, 2020) ("The significant, chronic underfunding of the IRS poses one of the most significant long-term risks to tax administration today, including reduced revenue collection, impaired taxpayer rights, and greater taxpayer burden.").

V. CONCLUSION

Federal tax law permits foreign actors to influence U.S. politics and policies through their interactions with American charities. This reality is a function of the fundamental design of federal income tax exemption under section 501(c)(3) and the federal excise tax system that regulates charities and their fiduciaries. The tax exemption requirements and excise taxes largely reinforce state law fiduciary duties and norms. Although tax laws do so over-inclusively in some respects, they do not stray far from this design. Even the existing restrictions on lobbying, and the prohibition against political campaign intervention, safeguard against only the most obvious exploitation of charities by politically motivated foreign actors.

How the law should respond to foreign influence on democratic processes and policymaking through a foreign actor's dealings with domestic charitable organizations is a complex inquiry. The support of domestic charities by many foreign donors should be welcomed. But certain types of support should be scrutinized closely. Direct and indirect contributions from foreign governments are often suspect, as are contributions from those who stand to benefit from a lack of policy coordination between the U.S. federal government and foreign governments.

Federal tax law can be reformed to address some of these concerns. One reform is requiring domestic charities to disclose publicly gifts they receive from foreign donors, as well as the identity of foreign donors. Another possible reform is to constrain the ability of SOs and organizations sponsoring DAFs to attempt to influence legislation and executive and administrative action, although this option raises concerns because it undermines core First Amendment speech and petitioning norms. More broadly, the disparate tax treatment of electioneering, lobbying, and influencing administrative agencies and executive officials should be critically evaluated. Clear attribution rules when a charity officer or employee provides executive branch access favors to donors are also worthy of deliberation. Perhaps the most aggressive tax reform idea that should be debated is to prohibit or limit a domestic charity, or at least certain types of charities (i.e., SOs and organizations sponsoring DAFs), from knowingly receiving a gift from any foreign government.

However, reform should extend beyond the federal taxation of charitable organizations. Some, and probably much, regulation of foreign interaction with politically active domestic charities should reside outside the IRS. The IRS is not the best agency for judging the propriety of numerous types of dealings between foreign actors and U.S. charities. The IRS lacks the necessary expertise and funding to comprehensively oversee a problem so complicated. One or more federal agencies that are better equipped to advance U.S. foreign policy interests and to preserve the integrity of democratic processes in this country should augment the role that the IRS properly serves.