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Why All Is Not Quiet on the Home Front for Charitable Organizations

Nina J. Crimm

WHY ALL IS NOT QUIET ON THE "HOME FRONT" FOR CHARITABLE ORGANIZATIONS

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INTRODUCTION

All has been relatively quiet on the "home front" for nonprofit organizations for many years. Historically, nonprofit organizations encountered challenges, for the most part, from the Internal Revenue Service (IRS) as it considered an organization's initial application for tax-exempt status under Internal Revenue Code (I.R.C.) § 501(a) or an organization's continued deservedness of tax-exempt status. However, the formerly quiescent "home front" has awakened. Over the past twenty-five years, and in the last ten years in particular, a number of state and local activists and politicians have called for reviews or studies or have enacted reforms of state and local tax policies on exempting nonprofit organizations from taxation.[1] State and local tax authorities also have taken an increased interest in challenging nonprofit organizations' tax-exempt status.[2] Government officials, such as state

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1. *See* Fred Stokfeld, *Colorado Initiative Would Repeal Nonprofits' Property Tax Initiative*, 72 TAX NOTES 1352 (1996); Thomas J. Billitteri, *Rethinking Who Can Sue a Charity*, CHRON. PHILANTHROPY, Mar. 12, 1998, at 1; *Charity Care at State's Nonprofit Hospitals Exceeds Estimated Tax Liability, Study Says*, DAILY TAX REP., (BNA) No. 103, at H-2 (May 29, 1998), *available in* WL, BNA-DTR File (recounting that Michigan's Department of Treasury, in early 1997, scrutinized tax-exempt nonprofit hospitals at the state legislature's request); Virginia Culver, *Amendment to Tax Colorado Nonprofits Loses Big*, DENVER POST, Nov. 6. 1996, at AA1, *available in* 1996 WL 12635827; *Governor Approves Uniform Standards for Charitable Property Tax Exemptions*, DAILY TAX REP., (BNA) No. 232, at H-1 (Dec. 3, 1997), *available in* WL, BNA-DTR File (reporting that Pennsylvania Governor Tom Ridge signed legislation on November 26, 1997, to clarify the standards that nonprofit organizations must satisfy for tax exemption); *Legislative Council to Study Property Tax Reform Over Interim*, DAILY TAX REP., (BNA) No. 102, at H-1 (May 28, 1997), *available in* WL, BNA-DTR File (indicating that the North Dakota Legislative Council would study property tax reform over subsequent eighteen months); *Policies on Tax Exemptions for Nonprofit Organizations Under Review, Official Says*, DAILY TAX REP., (BNA) No. 225, at H-2 (Nov. 21, 1997), *available in* WL, BNA-DTR File (recounting that the District of Columbia is reviewing and considering changing its policies providing Tax Exemptions for nonprofit organizations); Barbara A. Simon, *Colorado Debates Abolishing Tax exemption for Churches*, FREEDOM WRITER, March 1996, at http://www.berkshire.net/~ifas /fw/9603/legal.html; David Vise, *District to Go After Tax-Exempt Groups: Fannie Mae, Others Eyed for Funds*, WASHINGTON POST, Jan. 25, 1995, at A1, A7, *available in* 1995 WL 2075049; Grant Williams, *New Pa. Law and Court Ruling Specify Standards for Tax Exemptions*, CHRON. PHILANTHROPY, Dec. 11, 1997, at 41 (describing movement in Pennsylvania to reform tax exemption standards for charitable organizations).

On the federal level, in the last several years politicians have reviewed, studied and reformed numerous federal tax policies and laws affecting charitable organizations. *See, e.g.*, Taxpayer Bill of Rights 2, Pub. L. No. 104-168, 110 Stat. 1452 (1996) (codified in scattered sections of 26 U.S.C.) (adding I.R.C. § 4958 to impose intermediate sanctions when I.R.C. § 501(c)(3) & (c)(4) organizations engage in an excess benefit transaction); *Hearings Before the House Subcomm. on Oversight of the Comm. on Ways and Means*, 102nd Cong. (June 15, 1993 & Aug. 2, 1993), *available in* 1993 WL 760168, and *Hearings Before the House Subcomm. on Oversight of the Comm. on Ways and Means*, 103rd Cong. (March 16, 1994), *available in* 1994 WL 224880 (hearings, commonly called the "Pickle Hearings", investigating the federal tax laws applicable to tax-exempt charitable organizations that included testimony implicating some charities in egregious behavior).

2. *See* Jimmy Swaggart Ministries v. Bd. of Equalization of California, 204 Cal. App.3d 1269, 250 Cal. Rptr. 891 (Cal. Ct. App. 1988); Santa Catalina Island Conservancy v. County of Los Angeles, 178 Cal. Rptr. 708 (Cal. Ct. App. 1982); New Jersey Carpenters Apprentice Training and Educ. Fund v. Borough of Kenilworth, 685 A.2d 1309(N.J. 1996); Holy Spirit Ass'n v. Tax Comm'n, 438 N.Y.S.2d 521 (N.Y. App. Div. 1981), *rev'd*, 435 N.E. 2d 662 (N.Y. 1982); Hospital Utilization Project v. Commonwealth, 487 A.2d 1306 (Pa. 1985); Biosciences Info. Serv. v. Commonwealth, 551 A. 2d 672 (Pa. Commw. Ct. 1988); Baptist Mem'ls Geriatric Ctr. v. Tom Green

attorneys general, appear to have an increased interest in promoting accountability of nonprofit organizations, their trustees and officers.[3] In some states, such as West Virginia, the county or district attorney assumes this role. These government officials appear increasingly ready to exercise their responsibilities for bringing actions to protect the public interest in the charitable organization, including supervising and enforcing interests in the organization's property and income devoted to charitable purposes and assuring the proper execution of fiduciary responsibilities of trustees and officers.[4] Many indicators point to an awakening of a previously "sleeping giant."

Economic conditions have contributed to the recent trend of exemption challenges encountered by nonprofits. Federal revenues received by nonprofit organizations declined during the 1980s and 1990s and budget projections show further declines.[5] The 1990-91 recession financially strained many state and local governments, and motivated searches for new tax revenue sources.[6] Municipalities

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County Appraisal Dist., 851 S.W.2d 938 (Tex. App. 1993); Dallas Symphony Ass'n., Inc. v. Dallas Co. Appraisal Dist., 695 S.W.2d 595 (Tex. App. 1985); Lamb County Appraisal Dist. v. South Plains Hosp.-Clinic, Inc., 688 S.W.2d 896 (Tex. App. 1985); Yorgason v. County Bd. of Equalization *ex rel.* Episcopal Management Corp., 714 P.2d 653 (Utah 1986); Utah County v. Intermountain Health Care, Inc., 709 P.2d 265 (Utah 1985); *see also* Janne G. Gallagher, *When Local Governments Come Calling: The Movement to Tax Charities*, 18 EXEMPT ORG. TAX REV. 25 (1997) (surveying the tax-exempt debate with a state-by-state update); Gary Taylor, *Hospital Sued in Novel Lawsuit*, NAT'L LAW J., Feb. 18, 1991, at 3 (discussing *Texas v. Methodist Hosp.*, No. 494212 (Tex. Dist. Ct. 1991)).

3. *See* James B. Lyon, *The Supervision of Charities in the United States by the Attorneys General (and Other State Agencies) and the Internal Revenue Service*, *in* NEW YORK UNIVERSITY 24TH CONFERENCE ON TAX PLANNING FOR 501(C)(3) ORGANIZATIONS 5-1, 5-9 to -10, 5-25 to -30 (1996); Gallagher, *supra* note 2, at 25-26, 32-33. Statistical information is not available to indicate the apparent increase in interest by the state and local authorities. Data has not been collected by the National Association of Attorneys General on the number of investigations or cases brought in this area. However, the general sense is that interest has increased over the past twenty-five years. *See* Lyon at 5-9 to -10, 5-25 to 5-30; Gallagher at 25-26

In most states, the attorney general has responsibility for overseeing and supervising charitable corporations and trusts. *See* JAMES J. FISHMAN & STEPHEN SCHWARZ, NONPROFIT ORGANIZATIONS 245 (1995). State attorneys general can bring civil actions to remove directors and officers for self-dealing, waste, diversion of a charitable organization's assets, or other breach of fiduciary duty. They can also attempt to cause an accounting by a nonprofit organization of its assets or to dissolve a charitable corporation for ultra vires acts. However, they do not have the power to manage the daily affairs of a charitable organization. *See id.* at 246-47; OFFICE OF THE OHIO ATTORNEY GENERAL, THE STATUS OF STATE REGULATION OF CHARITABLE TRUSTS, FOUNDATIONS, AND SOLICITATIONS, *in* COMMISSION ON PRIVATE PHILANTHROPY AND PUBLIC NEEDS, RESEARCH PAPERS [hereinafter FILER COMM'N RESEARCH PAPERS RESEARCH PAPERS] 2705, 2710-25 (1977); Marion Fremont-Smith, *Trends in Accountability and Regulation of Nonprofits*, *in* THE FUTURE OF THE NONPROFIT SECTOR 75, 75-76 (Virginia Hodgkinson et al. eds., 1989); Henry B. Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. PA. L. REV. 497, 600-01 (1981); Kenneth L. Karst, The *Efficiency of the Charitable Dollar: An Unfulfilled State Responsibility*, 73 HARVARD L. REV. 433, 449-60 (1960).

Twenty-six states now have a specific person in the attorney general's office to monitor charitable organizations. *See* Billitteri, *supra* note 1, at 35. Eleven of these states have two or more persons to monitor charitable organizations on a full-time basis. *See id.*

4. *See id.*

5. *See* JULIAN WOLPERT, WHAT CHARITY CAN AND CANNOT DO: A TWENTIETH CENTURY FUND REPORT 12-13 (1997); VIRGINIA A. HODGKINSON ET AL., THE IMPACT OF FEDERAL BUDGET PROPOSALS UPON THE ACTIVITIES OF CHARITABLE ORGANIZATIONS AND THE PEOPLE THEY SERVE 7 (1995).

6. *See* Peter Durantine, *Hart Standards; House Votes Next Week*, HARRISBURG PATRIOT, Nov. 20, 1997, at B3, *available in* 1997 WL 7548786; Robert Franklin, *Colorado Vote Could Prove Taxing for Nonprofits: A Colorado Campaign to Extend Property Taxes to Nonprofits Raises Issues from Tax Relief to Bigotry and Has Implications for Other States*, MINNEAPOLIS-ST.PAUL STAR-TRIBUNE, Nov. 3, 1996, at 25A, *available in* 1996 WL 6935071; Ralph Jimenez, *Money Crunch Has Assessors Casting Eyes at Exempt Groups; The Scramble for Tax Revenues Puts Some Groups in New Light*, BOSTON GLOBE, Apr. 19, 1992, at 13, *available in* 1992 WL 4172109;

also have faced tax base erosion as a result of the flight of businesses and residents to outlying areas.[7] Meanwhile, public outcries against higher property and income taxes have strengthened, and voters have opposed proposed measures to increase taxes.[8] These financially strapped state and local governments have targeted nonprofits as one means of resolving their pinched monetary and tax base dilemmas.[9]

Although tax revenues have risen in the past several years for many state and local governments,[10] challenges to nonprofit organizations have continued and grown in regularity.[11] This article explores non-economic considerations as well as economic forces that may have contributed to nonprofits' vulnerability to attack. The article suggests that economic stresses have not been the exclusive cause for heightened concerns demonstrated by state and local authorities with respect to nonprofit charitable organizations. The additional factors include: (a) the exercise of expanded monitoring functions by state and local officials as part of a

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Steve Marantz, *Boston Rethinking Exemption: Nonprofits' Funds Sought for City*, BOSTON GLOBE, Feb. 4, 1991, at 13, *available in* 1991 WL 7400162; Brooke A. Masters, *Judge Stops College's Tax Exemption; Pennsylvania Court Questions Nonprofit School's Charitable Function*, WASHINGTON POST, Aug. 18, 1994, at A9, *available in* 1994 WL 2435393; John Ramsey & Carol Shattuck, *Threats to Nonprofits are Gathering on the Horizon*, HOUSTON CHRON., Nov. 18, 1997, at 21, *available in* 1997 WL 13073497.

7. *See* WILLIAM G. COLMAN, CITIES, SUBURBS AND STATES; GOVERNING AND FINANCING URBAN AMERICA 41-44 (1975); JON C. TEAFORD, POST-SUBURBIA: GOVERNMENT AND POLITICS AT THE EDGE OF CITIES 96 (1997); Peter Mieszkowski & E.S. Mills, *The Causes of Metropolitan Suburbanization*, J. ECON. PERSPECTIVES, Summer 1993, at 135-47; Charlie Cain & Mark Hornbeck, *Detroit's Population Drop: If Residents Fall Below 1 Million, 1.5% Tax Paid By Suburbanites Would Become Illegal*, DETROIT NEWS, Nov. 19, 1997, at A1, *available in* 1997 WL 5604621; Royal Ford & Rachel Collins, *Boomtown Moves to the Country; City Families Seek Quieter Lifestyle*, BOSTON GLOBE, Nov. 16, 1997, at A1, *available in* 1997 WL 6280553; John Schmeltzer, *When Businesses Take Their Plants to Suburbs, Society Can Pay Big Bills, UIC Study Suggests More Use of Abandoned City Industrial Sites*, CHICAGO TRIBUNE, Sept. 15, 1996, at 1, *available in* 1996 WL 2708562; Tim Schreiner & Ramon G. McLeod, *Suburbs Big Winners in Census Cities Continue to Decline*, SAN FRANCISCO CHRON., Jan. 25, 1991, at A1, *available in* 1991 WL 4171755; James Tobin, *Suburb's Population Growth is Detroit's Loss*, DETROIT NEWS, Sept. 2, 1993, at A2, *available in* 1993 WL 6051486. *See generally* ANTHONY DOWNS, NEW VISIONS FOR METROPOLITAN AMERICA (1994) (analyzing problems that growth creates and focusing on regional and metropolitan solutions).

8. *See* Lee Berton, *Roll Call: Towns Fight for Right to Tax Some Property of Nonprofit Groups*, WALL ST. J., Dec. 14, 1994, at A1, *available in* 1994 WL-WSJ 2056625; Elsa Brenner, *Priests and Town Battle Over Business Zone and Taxes*, N.Y. TIMES, Nov. 16, 1997, at WC1, *available in* 1997 WL 8012181; Carey Goldberg, *In the "Live Free or Die" State, An Unpalatable Tax Decision*, N.Y. TIMES, June 29, 1998, at A1, *available in* 1998 WL 5417132; Adam Pertman, *Colorado Initiative Targets Church Tax Exemption*, BOSTON GLOBE, July 6, 1996, at 1, *available in* 1996 WL 6868335; *see also infra* note 38 and accompanying text (discussing California's Proposition 13 and voter resistance to increased property taxes).

9. *See* Marantz, *supra* note 6, at 13; Julia McCord, *A Taxing Issue*, OMAHA WORLD-HERALD, Mar. 16, 1996, at 57, *available in* 1996 WL 6009588; Pertman, *supra* note 8, at 1; David A. Vise & Howard Schneider, *Barry's Cuts Win Praise in Congress; Control Board Leader Says U.S. Should Boost Funds by $100 Million*, WASH. POST, Mar. 20, 1996, at 1, *available in* 1996 WL 3069874. *See also infra* notes 32-47 and accompanying text (discussing the financial pressures on governments).

10. *See* Elizabeth I. Davis & Donald J. Boyd, *The New Year Starts on a High Note*, 32 STATE REVENUE REP. 1, 1-3 (1998); Daniel Shaviro, *An Economic and Political Look at Federalism in Taxation*, 90 MICH. L. REV. 895, 895 (1992) (stating that in the thirty years up to 1992, state and local tax receipts more than doubled in real terms, increased relative to U.S. tax receipts and the gross national product); *Pennsylvania Fiscal Year Ends With Record Level of Revenue; New Fiscal Year Will Start With Unanticipated $111 Million Surplus*, P.R. NEWSWIRE, INC., June 30, 1990, <http://biz.yahoo.com/prnews/980630/pa_revenue_1.html>.

11. *See, e.g.*, Pinnacle Health Hosps. v. Dauphin County Bd. of Assessment Appeals, 708 A.2d 1284 (Pa. Commw. Ct. 1998) (reviewing the county's revocation of the tax-exempt status of the hospital); Unionville-Chadds Ford Sch. Dist. v. Chester County Bd. of Assessment Appeals, 692 A.2d 1136 (Pa. Commw. Ct. 1997) (deciding on a challenge to a public garden's tax-exempt status).

revitalization of federalism; (b) the efforts to direct funds to changing social needs; (c) the nonprofits' own behaviors; (d) the distrust of federal oversight of nonprofits; and (e) the growth and visibility of the nonprofit sector. Overall, this article alerts scholars and practitioners that the tax-exempt status for nonprofits is no longer a sacred topic. There is little to suggest that state and local tax authorities and attorneys general will be quiescent in the near future.

I. FEDERALISM AND DECENTRALIZATION

The beginning point for understanding the changing landscape for nonprofits requires an understanding of federalism. Federalism, which is at the core of this country's governmental structure, is based on the idea of decentralized authority. Federalism has deep roots in American constitutional history. The Articles of Confederation drafted in 1777 and ratified in 1781 reflected a mistrust of centralized governmental power. The Articles created a league of friendship among the states, which, while bound together as the United States, retained their individual sovereignty and independence. There was no unifying law, aside from an ineffective unicameral Congress, no single government and no established means of preventing states from taking advantage of each other. As a result of the chaos that resulted from nonunity, state delegates met in Philadelphia to remedy the turmoil. The Philadelphia Constitutional Convention proposed a constitution that created a national government with circumscribed powers; state sovereignties were maintained as repositories for all powers not delegated to the national government.[12] Concerns about the loss of state controls led to the proposal of the Bill of Rights to avoid discord and to assure ratification of the Constitution. The Bill of Rights protected numerous personal liberties from unwarranted intrusions by the national government, reserved undelegated power to the people, and specifically reserved to the states or the people all powers not specifically delegated in nor prohibited by the Constitution to the national government.[13]

The diffusion of the national focus has been cyclical. States have gained preeminence, relatively recently, after a long period of federal expansion.[14] The ebb

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12. *See* U.S. CONST. art. I, § 8 (enumerating Congress' powers). The most prominent supporters of this Constitution, known as Federalists, were James Madison and Alexander Hamilton, who together with John Jay published eighty-five essays aimed to persuade ratification of the Constitution. *See* THE FEDERALIST Nos. 17-20, 45-51 (Alexander Hamilton, James Madison & John Jay). Opponents, or Anti-Federalists, the most prominent of whom was Samuel Adams, expressed concerns about the loss of state controls.

13. *See* U.S. CONST. amends. I-IV, IX, X; CATHERINE DRINKER BOWEN, MIRACLE AT PHILADELPHIA 244-48, 282-91 (1966); ARCHIBALD COX, THE COURT AND THE CONSTITUTION 31-83 (1987); REX E. LEE, A LAWYER LOOKS AT THE CONSTITUTION 17-31 (1981); JETHRO K. LIEBERMAN, UNDERSTANDING OUR CONSTITUTION 140-194 (1968); BERNARD SCHWARTZ, THE BILL OF RIGHTS: A DOCUMENTARY HISTORY 762-67 (1971); *see also* Garcia v. San Antonio Metropolitan Transit Authority, 469 U.S. 528, 568-69 (1985) (Powell, J., dissenting) (quoting letter from Samuel Adams to Richard Henry Lee (Dec. 3, 1787)).

Some view federalism as a code for federal abdication. *See* Deborah Maranville, *Welfare & Federalism*, 36 LOYOLA L. REV. 1, 41 (1990); Harry N. Scheiber, *Federalism and the Legal Process: Historical and Contemporary Analysis of the American System*, 14 L. & SOC'Y REV. 663, 690 (1980).

14. *See* U.S. ADVISORY COMMISSION ON INTERGOVERMENTAL RELATIONS, THE QUESTION OF STATE CAPACITY 364 (1985) [hereinafter U.S. ADVISORY COMM'N]; Richard P. Nathan, *Defining Modern Federalism*, *in* NORTH AMERICAN & COMPARATIVE FEDERALISM: ESSAYS FOR THE 1900S 89-93 (Harry N. Scheiber ed., 1992); Frank J. Thompson, *New Federalism and Health Care Policy: States and the Old Questions*, 11 J. HEALTH POL., POL'Y & L. 647, 648-49, 664-65 (1986).

and flow of federalism continues to be an important topic for scholars.[15] Case law presents a historical tag for tracing the shift in federalism. For example, in 1985, the United States Supreme Court overruled *National League of Cities v. Usery*,[16] with *Garcia v. San Antonio Metropolitan Transit Authority*,[17] on the grounds that a state employer's exemption capacity was not sheltered from the federal Fair Labor Standards Act.[18] This was followed in 1992, by the Court's decision in *New York v. United States*,[19] which limited Congress' power to compel states to provide for disposal of low level nuclear waste.[20] Then, in 1997, the Court decided *Printz v. United States*,[21] which concluded that imposing the federal Brady Handgun Violence Prevention Act on chief state law enforcement officers was unconstitutional.[22]

There are many reasons for the establishment and encouragement of a decentralized governmental system. They include: (a) avoiding excess concentration of power in a central government by shifting power to state and local units;[23] (b) enhancing the development of political responsibility and its potential for increasing efficiency in government by benign competition and finding the appropriate level of government for a particular task;[24] (c) encouraging local experimentation and innovation;[25] and (d) permitting adaptations to account for local needs.[26]

The federal government has been a powerful source of control and funding for many socially valued programs for most of this century.[27] After World War II, the

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15. *See generally* FEDERALISM AND RIGHTS (E. Katz & G. Alan Tarr eds., 1996) (addressing moral federalism, that regards federalism as contributing to and becoming a medium for individual contributions to a democratic social and political order); Nathan, *supra* note 14, at 89-93 (discussing political federalism as perceived by Alexander Hamilton, James Madison, and more modern approaches); Shaviro, *supra* note 10, at 895 (discussing the expected expansion of state and local taxation and tax efficiency issues).

16. 426 U.S. 833 (1978).

17. 469 U.S. 528 (1985).

18. *See id.* at 555-57.

19. 505 U.S. 144 (1992).

20. *See id.* at 188.

21. 521 U.S. 898 (1997).

22. *See id.* at 944-45.

23. James Madison presented the concept of duality of the state and federal government systems as a means of a system of checks and balances for one another. *See* THE FEDERALIST NO. 51, at 323 (James Madison) (Arlington House, 1966); Nathan, *supra* note 14, at 91. Later the federal republic moved from Madisonian dual federalism to cooperative federalism, with state and federal governments implementing the goals of one another and assigning tasks to one another.

In recent years, the Supreme Court has asserted that federalism is not dead. *See, e.g.*, Garcia v. San Antonio Metropolitan Transit Authority, 469 U.S. 528, 567 (1985) (Powell, J., dissenting) ("States' role in our system of government is a matter of constitutional law, not of legislative grace."). *See also* Printz v. United States, 521 U.S. 898 (1997); Seminole Tribe v. Florida, 517 U.S. 44 (1996); United States v. Lopez, 514 U.S. 549 (1995); New York v. United States, 505 U.S. 144 (1992).

24. *See Printz*, 521 U.S. at 934-35; *New York*, 505 U.S. at 149-181.

25. See PHILIP WEINBERG, ENVIRONMENTAL LAW, CASES AND MATERIALS 394 (2d ed. 1998) ("It is one of the happy incidents of the federal system that a single courageous State may . . . serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country." (citing New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting))).

26. *See* GEORGE C. S. BENSON ET AL., THE AMERICAN PROPERTY TAX: ITS HISTORY, ADMINISTRATION, AND ECONOMIC IMPACT 1 (1965); COMPETITION AMONG STATES AND LOCAL GOVERNMENTS: EFFICIENCY AND EQUITY IN AMERICAN FEDERALISM 119 (Daphne A. Kenyon & John Kincaid eds., 1991).

27. *See, e.g.*, National Housing Act, 12 U.S.C. §§ 1701-1750 (1994); Social Security Act, 42 U.S.C. §§ 303, 401-26 (1994); Grants to States for Aid and Services to Needy Families with Children and for Child Welfare Services, 42 U.S.C. § 602 (1994); Maternal and Child Health Services Block Grant, 42 § U.S.C. 701-11 (1994);

public demanded that Washington provide public assistance because the state and local governments had become either dormant, indifferent or unable to provide the needed resources. Efforts were made during President Eisenhower's administration to restore some powers to states, but those efforts were not successful.

In the late 1960s, the federal government made some attempt to increase federal-state cooperation in a variety of areas.[28] One such attempt was the Tax Reform Act of 1969,[29] which expanded the involvement of the IRS in policing public charities and private foundations. The enactment of the private foundation provisions in one sense represented a federal preemption of the acceptable means of operation by private foundations. It also "established the groundwork for enforcement of the new federal requirements at the state level. . . . [T]he requirements of [Internal Revenue Code] § 508(e) were specifically designed to encourage and facilitate effective state involvement in the supervision of private foundations . . . ."[30]

This dual regulatory system was designed to encourage the federal government's regulation of the conduct of the private foundation through the imposition of penalty taxes on unacceptable behaviors and the state governments' regulation of private foundations' assets to assure their preservation for charitable purposes.[31] The enactment in 1969 of I.R.C. § 6104(c)(1),[32] which requires the IRS to notify appropriate state officials of its refusal to grant or its revocation of a nonprofit organization's tax-exempt status,[33] reaffirmed the duality of the federal-state system. At the same time, it weakly promoted the opportunity for state attorneys general to actively and positively enforce state tax exemption criteria and asset preservation

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Nathan, *supra* note 14, at 93.

28. Urban renewal, technology, coastal management, clean water and environmental programs were just a few of the areas in which federal-state cooperation was attempted, much of which was implemented through federal grants-in-aid. *See* NORMAN BECKMAN, CHANGING GOVERNMENTAL ROLES IN URBAN DEVELOPMENT, SHAPING AN URBAN FUTURE: ESSAYS IN MEMORY OF CATHERINE BAUERWURSTER 154-57 (1969); MICHAEL E. LEVY & JUAN DE TORRES, NATIONAL INDUS. CONFERENCE BD., INC., FEDERAL REVENUE SHARING WITH THE STATES, STUDIES IN BUSINESS ECONOMICS, NO. 114 (1970); NATIONAL SCIENCE FOUNDATION & STATE JOINT EFFORTS, SCIENCE FOR SOCIETY: PROCEEDINGS OF THE NATIONAL SCIENCE CONFERENCE HELD AT ATLANTA, GEORGIA 1 (John E. Mock ed., 1970); WALLACE OATES, STUDIES IN FISCAL FEDERALISM 181 (1991) (federal grants-in-aid to states rose from $7 billion in 1960 to $2.2 billion in 1970). *See also supra* note 23 (discussing James Madison's concept of duality of federal-state responsibilities).

29. Pub. L. No. 91-172, § 101, 83 Stat. 487 (1969) [hereinafter TRA of 1969] (enacting, within its provisions, I.R.C. §§ 508-09 and §§ 4941-45).

30. Marion R. Fremont-Smith, *Impact of the Tax Reform Act of 1969 on State Supervision of Charities*, 8 HARV. J. ON LEGIS. 537, 542 (1971).

31. *See id.* at 540-42. Moreover, because the TRA of 1969 did not cover public charities in the penalty tax provisions of I.R.C. §§ 4941-45, the need for state regulation of and enforcement with respect to these nonprofit organizations remained.

32. *See* TRA of 1969, § 101(e)(2).

33. *See* Fremont-Smith, *supra* note 30, at 553-54. It was reported that in 1973, the IRS provided 7800 notices of termination of the federal income tax exemptions of public charities, but only three states asked to inspect the IRS materials. *See* Donald C. Alexander, Comm'r of the I.R.S., Speech Before the Special Subcommittee on Charitable Trusts and Solicitations of the National Association of Attorneys General (Jan. 1974). In the 1970s, the IRS was making approximately 20,000 tax exemption determinations annually. *See* James Abernathy & Timothy Saasta, *Everything You Wanted to Ask About the IRS But Were Afraid to Know*, GRANTSMANSHIP CENTER NEWS, 1977, at 29. In fiscal year 1973, the IRS audited 14,958 private foundations, 2046 other I.R.C. § 501(c)(3) organizations and 1976 organizations in other tax-exempt categories. *See id.* at 31. In that same year, approximately 2.5% of the 80,000 public charities that filed returns were audited, of which approximately 1-2% led to proposed revocations of tax-exempt status and an unknown number led to modifications in status. *See id.* at 32.

standards based on information received from the federal government.[34] Assistant Commissioner of the IRS for Employee Plans and Exempt Organization, Alvin D. Lurie commented at the time:

> Within that broad and fundamental statement of our philosophy we see our regulatory powers as inextricably entwined with those of the states. The Internal Revenue Service makes tax exemption determinations, and monitors compliance with them. However, when a violation is discovered, the ability to invoke the jurisdiction of an equity court, with its broad and adaptable powers, is uniquely the province of the states. Only in certain limited circumstances can the Service take all of the steps necessary fully to protect the public. . . .
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> Under that section [I.R.C. § 6104(c)], our obligation is to let the state know whenever we have taken an adverse action against a public charity, or whenever we have determined to impose an excise tax or a penalty on a private foundation. . . . The state's role, as the statutory scheme contemplates in a private foundation case where correction remains outstanding, is to bring about "correction." The state alone can do this through the exercise of state equity powers.[35]

Thus, even within the confines of the tax laws as applied to public charities and private foundations, stricter overall federal controls and weak state involvement marked the late 1960s.

This trend continued in the early 1970s. The enactment in 1972 of federal revenue sharing programs was accompanied by stricter overall federal controls.[36] By the end of President Carter's administration, a growing consensus developed that federal programs were poorly managed and administered with too little accountability.[37] It was not until President Reagan's administration, when there was stagnation in Washington but overall general governmental activism, that the country experienced a major shift of power and responsibility from the federal government to the states, counties and cities. The result was substantial cutbacks in federal aid.[38] At the same time, constituents, recognizing the futility of placing

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34. *See* Alvin D. Lurie, Assistant Commissioner of the IRS for Employee Plans and Exempt Organizations, Speech Before the Third Annual Conference of the National Association of Attorneys General Special Committee on Charitable Trusts and Solicitations (Apr. 1975), *in Lurie Calls for Cooperation with States in Regulating Charitable Organizations*, 43 J. TAX'N 58 (1975).

35. *Id.*; *see also* FILER COMM'N RESEARCH PAPERS RESEARCH PAPERS, *supra* note 3 (considering whether the equity enforcement power reserved for the states should be transferred to the federal level). Assistant Commissioner Lurie indicated in an interview that the IRS would find it useful if such equity power were given to the Department of Treasury or to the IRS specifically because of the relative passivity of states' attorneys general in charitable trust enforcement. *See* Abernathy & Saasta, *supra* note 33, at 33. Prior to 1969, the Department of Treasury had proposed that equity power be shifted to the federal courts to be triggered by the IRS if an attorney general failed to act to protect the public. *See id.*

36. *See* Lurie, *supra* note 34.

37. *See* John Herbers, *The New Federalism: Unplanned, Innovative and Here to Stay*, GOVERNING, Oct. 1987.

38. *See id.* at 28-34. For example, during the 1970s, the federal government had provided large amounts of funding and grants aimed at nonprofit health care providers, but in the 1980s, federal funding was cut dramatically. *See* KAREN DAVIS ET AL., HEALTH CARE COST CONTAINMENT 1-69 (1990); Nina J. Crimm, *Evolutionary Forces: Changes in For-Profit and Not-For-Profit Health Care Delivery Structures; A Regeneration of Tax Eexemption Standards*, 37 B.C. L. REV. 1, 18-21 (1995); Robert H. Lovic & Joanne Gentry, *Health Maintenance Organizations (HMOs)—A 15 Year Perspective*, DIMENSIONS HEALTH CARE, Nov. 1984, at 1;

demands on Washington, turned to the state and local governments. This political movement pressured previously quiescent state, city and local governments into financially supporting and involving themselves in new social and economic programs.[39] There was a return to the ideals of federalism and its implementation, with the state and local governments taking up the gauntlet—"a change that promises to be both more profound and more permanent than most people have recognized."[40]

Today's state and local governments, in exercising their sense of independence from the federal government, seem to have been reassessing the roles and functions of the nonprofit sector and of many of the organizations that comprise it. Governments surely realize that when nonprofit tax-exemptions are eliminated, their involvement in nonprofit organizations' operations has the potential to expand in numerous ways. For example, the government could value the organization's property for property tax purposes. The organization's failure to pay such taxes might give rise to tax liens or tax foreclosures. In each of these situations, the government would be directly involved in confrontations, conflicts and legal processes.

It appears that the evaluation process of what is the proper relationship between government and nonprofits has focused on a variety of considerations. These include the jurisdictions' economic needs, reconsideration and redefinition of current social needs of the constituent public, behaviors of nonprofit organizations, public distrust of the organizations and of the IRS. It also includes the sheer growth and visibility of the modern nonprofit sector.

II. ECONOMIC NEEDS OF JURISDICTIONS

Economic recessions have been no stranger to this country throughout its history, even during the past twenty-five years.[41] Most recently, the recession of 1990-1991

Theresa McMahon, *Fair Value? The Conversion of Nonprofit HMOs*, 30 U.S.F. L. REV. 355, 358 (1996). Moreover, between 1980 and 1984, nonprofit organizations other than health care providers lost $4.5 billion (26.7%) of their federal support, with social service, community development and educational organizations particularly affected. *See* Lester Salamon, *The Invisible Partnership: Government and the Nonprofit Sector*, 1 BELL ATLANTIC Q. 37, 42 (1984).

39. Funding of these programs was accomplished in part by state and local governments' raising new taxes, primarily income taxes and user fees, even as California's Proposition 13 tax revolt took place. *See* Herbers, *supra* note 38, at 32-34. Some commentators contend that while states' administrative abilities to tax and to spend have increased, their actual capabilities to do so has declined. *See, e.g.*, Thompson, *supra* note 14, at 647, 648-49, 664-65 (noting variations in tax rates and abilities of states to raise taxes and make expenditures).

40. Herbers, *supra* note 38, at 28-29, *see also* U.S. ADVISORY COMM'N, *supra* note 14, at 364 (discussing how states have gained preeminence relatively recently).

One arguably unintended impact of centralizing responsibility for social and economic programs in state and local governmental units may be the reduction of a commitment to pluralistic viewpoints that decentralization of responsibility encourages. *See* BRUCE HOPKINS, THE LAW OF TAX-EXEMPT ORGANIZATIONS 27 (6th ed. 1992); Norman Fink, *Taxation and Philanthropy—A 1976 Perspective*, 3 J.C. & U.L. 1, 1 (1976); William R. Ginsberg, *The Real Property Tax Exemption of Nonprofit Organizations: A Perspective*, 53 TEMP. L. Q. 291, 311 (1980) (stating that the "exemption evidences a social and cultural commitment to a degree of decentralization and autonomy not only in the provision of public goods and the performance of public services, but in the definition of public function as well").

41. This nation's economy was beset by recessions in 1973-75, 1981-1982, and 1990-1991. *See* ROBERT E. HALL, BOOMS AND RECESSIONS IN A NOISY ECONOMY 34 (1991); Ted J. Smith III & S. Robert Lichter, *Lessons in Mass Media Depiction of Economic Conditions During a Recession*, *in* LESSONS FROM THE RECESSION 11-45

financially strained the treasuries of many state and local governments. During the same time frame, some cities encountered tax base erosion as a result of the flight of industry and residents to outlying areas.[42] Many businesses moved operations abroad to take advantage of lower labor costs and other financial economies, further narrowing the tax bases of state and local governments.[43] Many individuals and groups felt that there were inequities in the system because property taxes were falling on remaining citizens and businesses.[44] The issue of unfairness of tax burden was heightened when tax-exempt nonprofit organizations appeared to use state and local services to benefit persons well beyond local and/or state boundaries.[45] Overall, there was vocal public resistance to paying taxes.[46]

(Sarah S. King & Donald P. Cushman eds., 1997).

42. *See* McCord, *supra* note 9, at 57; *supra* note 7 (discussing movements of residents and businesses to suburbs).

43. *See Made Outside the U.S.A.*, J. BUS. STRATEGY, Nov./Dec. 1996 at 1; John Balzar, *News Analysis: For Some, Tumult of 1996 Parallels 1896's Gilded Age; Politics: Observers Point to Era's Unbridled Capitalism, Rise of Populism*, L.A. TIMES, Feb. 17, 1996, at A1, *available in* 1996 WL 5241760; Debby Garbato, *Spartus Shutting U.S. Plant to Cut Costs; Spartus Home Furnishing*, 66 HFD—THE WEEKLY HOME FURNISHINGS NEWSPAPER 45 (1992); *Lift Truck Maintenance Program Pays Dividends: Inside Warehousing & Distribution; A Special Section on Increasing Productivity*, 29 TRANSP. & DISTRIB. 60 (1988); Mel Mandell, *Asia: Converting Crisis to Opportunity*, WORLD TRADE, Apr. 1998, at 36-39; David Orgel, *U.S. Interlining Companies Seeking Far East Business*, 23 DAILY NEWS RECORD 2 (1983); Tim Shorrock, *NY Garment Firm Strike Highlights Conflict Over Jobs, Union Labor*, J. COMMERCE, June 10, 1994, at A10; Yvonne D. Sinakin, *Early Involvement Making A Global Connection*, ELEC. BUYERS' NEWS EXTRA-CONNECTORS, Aug. 19, 1996 at S36; *U.S. Bakers Find New Markets; Includes Department of Commerce Statistics for Direct Investments Abroad in Food Manufacturing*, 71 MILLING & BAKING NEWS 26 (1996).

44. *See* William Glaberson, *In Era of Fiscal Damage Control, Cities Fight Idea of "Tax-exempt"*, N.Y. TIMES, Feb. 21, 1996, at A1, *available in* 1996 WL 7492679; Editorial, *Leave Churches Untaxed*, ROCKY MTN. NEWS, Sept. 15, 1996, at 79A, *available in* 1996 WL 12346001; Donna Liquori, *City Turns to Charity for Help*, L.A. TIMES, May 14, 1995, at A20, *available in* 1995 WL 2046052; Editorial, *Taxpayers Deserve a Break From Churches*, USA TODAY, Oct. 17, 1996, at A14, *available in* 1996 WL 2072406.

45. *See* L. Richard Gabler & John F. Shannon, *The Exemption of Religious, Educational, and Charitable Institutions from Property Taxation*, *in* FILER COMM'N RESEARCH PAPERS RESEARCH PAPERS, *supra* note 3, at 2535, 2546-47; Rebecca S. Rudnick, *State and Local Taxes on Nonprofit Organizations*, 22 CAP. U. L. REV. 321, 336-37 (1993); Bradford H. Gray, *Why Nonprofits? Hospitals and the Future of American Healthcare*, 8 FRONTIERS HEALTH SERVS. MGMT. 3 (1992); Roger C. Nauert et al., *Hospitals Face Loss of Federal Tax-Exempt Status*, HEALTHCARE FIN. MGMT., Sept. 1988, at 48, 50; Helena G. Rubenstein, *Nonprofit Hospitals and the Federal Tax Exemption: A Fresh Prescription*, 7 HEALTH MATRIX 381 (1997). The Supreme Court recently struck down a Maine property tax exemption because it favored institutions that served in-state residents. *See* Camps Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564 (1997); Evelyn Brody, *Hocking the Halo: Implications of the Charities' Winning Briefs in Camps Newfound/Owatonna Inc.*, 20 EXEMPT ORG. TAX REV. 31 (1998); Marlis L. Carson, *Justices Ponder Non-Profit's Property Tax Exemption Dispute*, 73 TAX NOTES 126 (1996).

46. *See* PARRIS N. GLENDENING & MAVIS MANN REEVES, PRAGMATIC FEDERALISM: AN INTERGOVERNMENTAL VIEW OF AMERICAN GOVERNMENT 141-44 (1977); Ginsberg, *supra* note 40, at 294-95; Stephen Hayward, Commentary, *Annals of the Taxpayer Rebellion*, WASHINGTON TIMES, June 27, 1998, at C3, *available in* 1998 WL 3451587; Ralph Jimenez, *Conservatives Join the Fight vs. N.H. Tax Plan*, BOSTON GLOBE, June 6, 1998, at B1, *available in* 1998 WL 9137414; *Vermont Officials Warn Towns They'll Regret Any Tax Revolt*, ALBANY TIMES UNION, May 22, 1998, at A5, *available in* 1998 WL 7259904.

In 1978, Californians had voted for Proposition 13 in order to place a ceiling on residential property taxes. Their taxes had risen quickly and significantly because inflation had increased the assessed value of homes. Although taxpayers discovered that the California government's treasury expanded significantly as a result of the higher property assessments, they found that they personally were hurt financially. Proposition 13 had a substantial impact not only on California, but also across the nation. The same inflationary forces had affected property values, assessments and taxes in other states, and taxpayer resistance to increased property taxes spread. *See* John Wildermuth, *Prop. 13: The People's Revolution/1978 Tax Rebellion Turned Initiatives Into a Political Powerhouse*, SAN FRANCISCO CHRON., May 20, 1998, at A1, *available in* 1998 WL 3914197.

The financial stresses prompted state and local governments to seek new tax revenue sources. Some state and local governments chose to increase taxes, primarily income and sales taxes.[47] Many jurisdictions instituted an alternative idea: cash contributions known as "payments in lieu of taxes" or PILOTs. Organizations or governmental units agree to make these payments to jurisdictions, often conceptualized either as a substitute for property taxes or in payment for services received, for items such as police, fire protection and garbage removal.[48] PILOTs can be paid by larger governmental bodies to smaller ones, by for-profit businesses and by nonprofits in return for tax-favored treatment.[49] PILOTs may be based on an organization's or government's ability to pay.[50] Boston undertook the first major organized effort to institute a systematic PILOT program involving nonprofit property owners.[51] As of 1997, 51% of Boston's property was exempt from taxation and owners were encouraged to pay PILOTS.[52] Harvard College was the first major institutional university to formally agree to a PILOT plan. Harvard has made payments to Cambridge since 1929.[53] As of 1990, Harvard paid Cambridge approximately $1.1 million in PILOTs on tax-exempt property valued at $71 million.[54] Other higher education institutions have been approached by cities to pay PILOTs, as well.[55] It has been argued, however, that PILOTs "erode the value of tax exemption. These alternatives would recover only a part of the revenues foregone by tax exemption and would not constitute the equivalent of placing such

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47. *See* Herbers, *supra* note 38, at 34 (stating that more than half of the states increased personal income or sales taxes and most states increased user fees); Samuel Rosen, Letter to the Editor, *Proposition 13's Legacy*, L.A. TIMES, June 7, 1998, at B16, *available in* 1998 WL 2434854; Stephanie Simon, *20 Years Later, Prop. 13 Still Marks California Life Government: It Reined in Property Tax Structure But Unplanned Consequences—Good and Bad—Are Legion*, L.A. TIMES, May 26, 1998, at A1, *available in* 1998 WL 2430968; Wildermuth, *supra* note 46, at A1; *see also* Kirk G. Siegel, Comment, *Weighing the Costs and Benefits of Property Tax Exemption: Nonprofit Organization Land Conservation*, 49 ME. L. REV. 399, 399 n.1 (1997) (reviewing the current pressures on states because of tax issues).

48. *See* ALFRED BALK, THE FREE LIST. PROPERTY WITHOUT TAXES 119, app. at 170 (1971); *The Tax-exempt Status of Western Pennsylvania Hospitals: Bases for Exemption; Implications of Change*, [hereinafter *Western Pa. Hosps.*], HEALTH POLICY INSTITUTE, HPI SERVICES #16, Apr. 1990, at 37-38 (citing: H. Larkin, *Financial Success May Invite Local Tax Scrutiny*, HOSPS., Oct. 5, 1988, at 30, 32); Gallagher, *supra* note 2, at 28-29, 32-33; Dan Pellegrini, *Hospital Tax Exemption: A Municipal Perspective*, 5 FRONTIERS OF HEALTH SERVS. MGMT. 44-46 (1989); Caroline Abels, *School Districts Try to Block New Tax Law*, PITTSBURGH POST-GAZETTE, Dec. 19, 1997, at B4, *available in* 1997 WL 16586392; Dick Dawson, *Expert Urges Against Canterbury Woods Tax Break*, BUFFALO NEWS, Dec. 10, 1997, at B4, *available in* 1996 WL 5885154; Franklin, *supra* note 6, at A25; Glaberson, *supra* note 35, at A1; Richard Higgins, *Tax Idea Angers Charities, Framingham May Ask for Property Payments*, BOSTON GLOBE, July 6, 1997, at WW1, *available in* 1997 WL 6260387.

49. *See* Gallagher, *supra* note 2, at 28-29.

50. *See Western Pa. Hosps.*, *supra* note 48, at 37-38.

51. *See* Gallagher, *supra* note 2, at 28.

52. *See Western Pa. Hosps.*, *supra* note 48, at 37 (citing T. J. JANKOWSKI, ANNUAL REPORT OF THE TAX-EXEMPT PROPERTY STEERING COMMITTEE FOR FISCAL YEAR 1987).

53. *See* Gabler & Shannon, *supra* note 36, at 2560; Gallagher, *supra* note 2, at 28; *Harvard Will Pay More to Cambridge According to Accord*, N.Y. TIMES, Nov. 28, 1990, at B9, *available in* 1990 WL 2014106.

54. *See* Gallagher, *supra* note 2, at 28.

55. *See Exemption Challenges Continue*, STATE TAX TRENDS FOR NONPROFITS, 1990, at 6 (reporting Pittsburgh's attempts to obtain PILOTs from University of Pittsburgh, Duquesne University and local colleges). In 1990, Yale University agreed to pay the city of New Haven approximately $2.6 million, slightly under $1.6 million annually to be used for the fire department's budget, and a one-time payment of $1.1 million to turn two streets into pedestrian walkways. *See Yale Agrees to Pay New Haven for City Services*, STATE TAX TRENDS FOR NONPROFITS, 1990, at 2. It also agreed to put its golf course back on the city's property tax assessment rolls. *See id.*

institutions back on the property tax rolls."[56] Nevertheless, it is worth watching to determine whether PILOTs are part of an effective solution to governments' tax shortages.

The changed (and still evolving) world and national economies have encouraged competitive or economic federalism—that is, federal, state and local governmental units have tried to survive and to achieve heightened levels of potential efficiencies and economic development.[57] Critical to these ambitions and to goals of decentralized and independent self-governance by state and local governments has been their ability to raise tax revenues.[58] Although the income tax is important to most state and local governments[59], the property tax historically has been and continues to be the single largest source of revenue for local governmental units.[60] Even though these local jurisdictions depend on property taxes to meet their financial obligations,[61] by comparison every state grants a property tax exemption to various categories of nonprofit organizations within the independent sector.[62]

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56. *See* Gabler & Shannon, *supra* note 45, at 2559-60.

57. *See* Herbers, *supra* note 38, at 34; Suellen M. Wolfe, *Municipal Finance and the Commerce Clause: Are User Fees the Next Target of the "Silver Bullet"?*, 26 STETSON L. REV. 727, 728 (1997).

58. States' taxing power comes from residual powers not delegated to the federal government by the U.S. Constitution nor prohibited thereby. *See* U.S. CONST. amend X. Limitations on states' taxing powers come from three sources—the U.S. Constitution, states' laws, and political realities. *See* Glendening & Reeves, *supra* note 46, at 139. Local governments have the least taxing power of any governmental unit, which accounts for their dependency on property tax to meet revenue needs. *See id.* at 140.

59. Most states impose an income tax on individuals and corporations (the notable exceptions include Connecticut and Texas).

60. There are some interesting property tax statistics: (1) property tax revenue comprises approximately 75% of all tax revenues received by local governments and slightly less than half of the revenues from all income sources, including user fees and state payments received; (2) property taxes range from approximately 98% of school tax revenue to about 52% of city tax revenue; (3) in the western states, property taxes account for approximately 71% of all local revenues; and (4) in the New England states, they comprise 98% of all local revenues. (States create classes for real property taxation, which sets the tax base for local property.) *See* GLENN W. FISHER, THE WORST TAX? A HISTORY OF THE PROPERTY TAX IN AMERICA 200-204 (1996) (citing U.S. BUREAU OF THE CENSUS, HISTORICAL STATISTICS OF STATE AND LOCAL FINANCES, 1902-1953 (1955) and U.S. BUREAU OF THE CENSUS, GOVERNMENT FINANCE (various years)); *see also* HENRY J. AARON, WHO PAYS THE PROPERTY TAX? A NEW VIEW 9-11 (1975); BENSON, *supra* note 26, at 72-73, 83; JENS PETER JENSEN, PROPERTY TAXATION IN THE UNITED STATES 1 (1931); Peter Swords, *Charitable Real Property Tax Exemptions in New York State: Menace or Measure of Social Progress*, B. ASS'N N.Y.C., 1981, at 24.

61. Local jurisdictions often depend on the property tax to finance schools as well as other local services. *See* Lawrence Susskind & Cynthia Horton, *Proposition 2-1/2: The Response to Tax Restrictions in Massachusetts, in* RESTRICTIONS IN LOCAL FINANCE 158, 164-65 (C. Lowell Harris ed., 1983); Sharon N. Humble, *The Federal Government's Machiavellian Impediment of the States' Collection of Property Taxes Through the FDIC's Regulation at Failed Financial Institutions: Does the End Justify the Liens?*, 25 ST. MARY'S L.J. 493, 499 (1993).

62. Historically many states have permitted tax exemptions, whether for income, property or sales tax, based on a non-profit organization obtaining a tax exemption by the IRS. *See* James P. Buchele, *Justifying Real Property Tax Exemptions in Kansas*, 27 WASHBURN L.J. 252 (1988); N. Keith Emge, Jr., Note, *Nonprofit Hospitals and the State Tax Exemption: An Analysis of the Issues Since Utah County v. Intermountain Health Care, Inc.*, 9 VA. TAX REV. 599, 599 (1990); Ginsberg, *supra*, note 40, at 291; Nauert, *supra* note 45, at 52. The previously near-automatic state grant has been curtailed in some states, and some states' laws regarding tax exemption now diverge significantly from that of I.R.C. § 501(c)(3). *See* John W. O'Donnell & James H. Taylor, *The Bounds of Charity: The Current Status of the Hospital Property-Tax Exemption*, 322 NEW ENG. J. MED. 65 (1990); Margaret A. Potter & Beaufort B. Longest, Jr., *The Divergence of Federal and State Policies on the Charitable Tax Exemption of Nonprofit Hospitals*, 19 J. HEALTH POL., POL'Y & L. 393 (1994); Mark F. Baldwin, *Legislatures, Agencies Debating Whether Not-for-Profit Hospitals Deserve Their Tax-exempt Status*, MODERN HEALTHCARE, May 22, 1987, at 34; David A. Hyman & T.J. McCarthy, *Property Tax Exemptions: Headed for Extinction?*, HEALTH PROGRESS, Dec. 1988, at 32.

For example, the Texas legislature enacted new provisions significantly restricting the property tax

Today, property taxes are an insignificant source of revenue for most state governments.[63]

The allowance of the property tax exemption (and other tax exemptions) to nonprofit organizations is not sacrosanct; governmental units may circumscribe them. It should be no surprise then that the nonprofit sector, which owns valuable properties against which taxes can be assessed,[64] has been vulnerable to challenge

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exemption for charitable nonprofit organizations and narrowly defining the terms "nonprofit hospital" and "charitable" in connection with care for indigents. *See* TEX. CONST. art. VIII, § 2(a)(1995); TEX. TAX CODE § 1.18 (West 1995); TEX. HEALTH & SAFETY CODE § 311.043 (West 1995). In other states, the judiciary has established specific criteria, based on existing statutes, for the determination of whether hospitals are "charitable" and entitled to some type of tax exemption. The Utah Supreme Court interpreted a clause in the Utah Constitution to require that hospitals prove entitlement to a property tax exemption on an annual basis. *See* Utah County v. Intermountain Health Care, Inc., 709 P.2d 265 (Utah 1985). Now, nonprofit hospitals in Utah must submit annual financial and operating information for examination by county tax assessors to determine whether the hospitals satisfy the Utah Supreme Court's multi-factor test of charitability and thus warrant tax exemption for the year. *See infra* notes 75-79 and accompanying text.

Only churches, nonprofit cemeteries, and charities are tax-exempt in all states and the District of Columbia. Hospitals, healthcare institutions or educational institutions are not exempt in every state. *See* E. C. LASHBROOKE, JR., TAX-EXEMPT ORGANIZATIONS 97-108 (1985). As of 1985, hospitals and healthcare institutions were not specifically exempted (but could have been exempted under "charitable" category) by statute in Alabama, Colorado, Iowa, Kentucky, Massachusetts, Michigan, Missouri, Nebraska, Nevada, New Hampshire, New Mexico, North Dakota, Oklahoma, Oregon, Pennsylvania, South Carolina, Tennessee, Texas, Utah, Vermont, Washington, or Wisconsin. *See id.* at 109-11. As of 1985, educational organizations were not specifically exempted by statute in Iowa, Massachusetts, Oregon, Vermont, Virginia, or West Virginia. *See id.*; Gabler & Shannon, *supra* note 45, at 2535; Charles T. Clotfelter, *Tax-Induced Distortions in the Voluntary Sector*, 39 CASE W. RES. L. REV. 663, 678 (1988-89); Ginsberg, *supra* note 31, at 292; Rubenstein, *supra* note 45, at 381 n.5 (1997) (setting forth each state statute regarding hospitals' tax exemption).

These state property tax exemptions usually do not mirror the federal income tax exemption, but rather are covered by independent state statutes or constitutional provisions. In many states, such as New York, wholly tax-exempt property includes charitable organizations. The availability of data on the value of wholly tax-exempt property varies widely among the states. Few states are able to report the value of wholly exempt real property by type of exemption. *See* U.S. DEPT. OF COMMERCE, BUREAU OF THE CENSUS, ASSESSED VALUATIONS FOR LOCAL GENERAL PROPERTY TAXATION, CENSUS OF GOVERNMENTS xi (1992). In 1995, of all taxable and exempt property in New York, wholly exempt property accounted for approximately 21%. *See* N.Y. ST. OFFICE OF REAL PROPERTY SERVS., ANNUAL REPORT 2 (1995).

Although significant amounts of foregone potential tax revenues are attributable to nonprofit charitable organizations, comparatively, such potential revenues comprise but a small portion of all property tax uncollectible by state and local governments as a result of exemptions. It was estimated that in 1977, approximately one-third ($15 billion of potential property taxes) of all property was tax-exempt and one-third ($5 billion in potential taxes) of that exempt property (that is, one-ninth of all property) was attributable to private holdings whereas two-thirds was attributable ($10 billion in foregone tax revenues or shifted to taxable properties) to government or government affiliated holdings. *See* Gabler & Shannon, *supra* note 45, at 2535-41. In 1971, in New York, 30% of all real property was exempt from property taxes, but two-thirds of the exempt property was government-owned. At the same time, over 80% of all property in New York City was government-owned. *See* Ginsberg, *supra* note 40, at 298-99, 302 (providing information on statistics with respect to many states). *See also* CITY OF NEW YORK, ANNUAL REPORT OF THE TAX COMMISSION FOR THE FISCAL YEAR 1976-1977 30 (1977) (showing 83.6% of New York City tax-exempt property as government-owned in 1977); Richard Higgins, *supra* note 48, at 1 (stating that the largest holder of exempt property in Framingham, Massachusetts was the "town, followed by the state, charitable institutions, churches, and schools").

63. *See* Fisher, *supra* note 60, at 200. By the beginning of this century, states had diversified their tax systems and during the post-World War II period their dependence on property taxes declined. *See id.*

64. For example, in the District of Columbia, apart from non-taxable governmental property, the largest portion of the tax breaks are attributable to universities, international concerns and other nonprofit organizations that pay no income taxes, and in many cases pay no property taxes. The biggest private owners of tax-exempt property are: George Washington University (assessed at over $600.7 million), World Bank (over $516.7 million), Georgetown University (over $398.5 million) and Howard University (over $375.5 million). *See* Vise, *supra* note 1, at A1, A7. However, the value of untaxed property owned by nonprofit organizations is far lower than

by financially strapped state and local governments.[65] Where nonprofits do not pay property or other taxes or fees for services,[66] they may be considered a financial drain on governmental resources.[67]

III. DIRECTING EFFORTS AND FUNDS TO CHANGING SOCIAL NEEDS

A goal of encouraging certain socially desirable behavior by nonprofit organizations in part may underlie fiscally stressed as well as financially secure state and local governments' strategies to circumscribe tax exemptions for the nonprofit sector through the development of entitlement criteria.[68] Whether an exemption is from payment of property, sales, or income taxes, entitlement standards generally identify and reflect notions of what constitutes relevant socially valuable services sufficient in quantity and/or quality to warrant tax advantaged treatment.[69] A government's application of these entitlement standards to each nonprofit organization to determine its deservedness of tax beneficial treatment assures that public funds are guided and available only to those nonprofit

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governmental property that is not subject to taxation.

65. *See, e.g.*, Holy Spirit Ass'n v. Tax Comm'n, 438 N.Y.S.2d 521, 531 (N.Y. App. Div. 1981) (stating that the tax exemption statute should be "strictly construed" and "its application by municipalities should be consistent with a legislative intent 'to stem the erosion of municipal tax bases by permitting local governments to terminate exemptions for nonprofit organizations other than those conducted exclusively for religious, educational, charitable, hospital or cemetery purposes'"), *rev'd*, 435 N.E.2d 662 (N.Y. 1982).

66. *See supra* notes 48-55 and accompanying text (discussing PILOTs).

67. Usually there also is a quid pro quo expectation that the nonprofit will provide social benefit commensurate with their consumption of governmental services and taxes from which they are exempt. A perceived insufficiency of furnishing social benefits may also make nonprofits targets for challenge by governmental units. *See* WILLIAM J. STROUSE, A COST/BENEFIT ANALYSIS OF PROVIDING TAX-EXEMPT STATUS TO NON-PROFIT HOSPITALS 3, 6, 15 (1997); Potter & Longest, *supra* note 62, at 398, 414-25; Dennis Zimmerman, *Nonprofit Organizations, Social Benefits, and Tax Policy*, 44 NAT'L LAW J. 341, 344-45 (1991); Berton, *supra* note 8, at A1.

68. *See* George T. Bell, *Where Have All the Charities Gone, or Have They?*, 66 PA. BAR ASS'N Q. 168, 168-69 (1995); Siegel, *supra* note 47, at 399, 401, 405-06; Dolores Kong, *States Eye Hospitals' Tax-Exempt Status*, BOSTON GLOBE, May 4, 1992, at 17, *available in* 1992 WL 4174277; Bill McAllister, *N.Y. Judge Places Tobacco Institute Under Control of Receiver*, WASHINGTON POST, May 3, 1998, at A13, *available in* 1998 WL 11578394; *see also* Santa Catalina Island Conservancy v. County of Los Angeles, 126 Cal. App.3d 236 (Cal. Ct. App. 1982); Yorgason v. County Bd. of Equalization of Salt Lake County *ex rel.* Episcopal Management Corp., 714 P.2d 653, 658 (Utah 1986).

69. The notion that a tax exemption to nonprofit organizations constitutes an indirect governmental subsidy has been both promoted and criticized by scholars, legislators, and courts. For example, a 1938 congressional report stated:

> [E]xemption from taxation of money or property devoted to charitable and other purposes is based upon the theory that the Government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds, and by the benefits resulting from the promotion of the general welfare.

H.R. REP. NO. 1860, 75th Cong. (1938); *see also* McGlotten v. Connally, 338 F. Supp. 448, 456 (D.D.C. 1974) ("[T]he Government relieves itself of the burden of meeting public needs which in the absence of charitable activity would fall on the shoulders of the Government."); Boris I. Bittker & George K. Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Taxation*, 85 YALE L. J. 299, 305 (1976); Note, *Developments in the Law—Nonprofit Corporations*, 105 HARV. L. REV. 1579, 1620-21 (1992).

Moreover, where a governmental unit statutorily provides a charitable deduction to persons who make donations to "deserving" charitable organizations, the governmental unit amplifies the effect of encouraging socially desirable behavior by institutions. Studies have shown that the availability of charitable deductions encourages charitable donations. *See* BURTON A. WEISBROD, THE NONPROFIT ECONOMY 93-95 (1988) (discussing studies and providing additional sources); CHARLES CLOTFELTER, FEDERAL TAX POLICY AND CHARITABLE GIVING 141 (1985) (noting lack of the tax exemption would decrease donations by 25%). To attract donations, charitable organizations' behavior will comport with the standards required to satisfy the statutory requirements.

organizations whose efforts are dedicated to and sufficiently comport with the provision of socially valuable services.[70] In this manner, the marketplace of services and providers can be directly impacted. Thus, governmental strategies encompassed in criteria for granting new or continued tax exemptions actively can create a useful tool for the orchestration and development of new institutional behavior patterns deemed important to meet current social needs.

Over the past two decades, numerous jurisdictions have re-examined their entitlement criteria for exemption from property or income taxes. Re-examination has been particularly visible with respect to health care institutions. Utah and Pennsylvania provide two specific examples. In 1985, the Supreme Court of Utah issued its opinion in *Utah County v. Intermountain Health Care*,[71] a case in which state and local Utah tax authorities challenged the tax-exempt status of two hospitals because the hospitals failed to provide uncompensated care to the sick. Based upon state constitutional principles of charity, the court reasserted that deservedness of the property tax exemption by nonprofit hospitals "exclusively" organized and operated for charitable purposes requires:[72]

> the *contribution* or *dedication* of something of value . . . to the common good. . . . By exempting property used for charitable purposes, the constitutional convention sought to encourage individual or group sacrifice for the welfare of the community. An essential element of charity is an *act of giving*. A gift to the community can be identified either by a substantial imbalance in the exchange between the charity and the recipient of its services or in the lessening of a government burden through the charity's operation.[73]

The majority stated that six factors must be weighed in determining whether a particular nonprofit uses its property exclusively for charitable purposes, the third of which directly addresses the definition of charity:

> (1) whether the stated purpose of the entity is to provide a significant service to others without immediate expectation of material reward; (2) whether the entity is supported, and to what extent, by donations and gifts; (3) whether the recipients of the "charity" are required to pay for the assistance received, in whole or in part; (4) whether the income received from all sources (gifts,

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70. To compound this impact of directing funds to certain perceived social needs, if a tax-exempt organization loses its exemption from income taxes, it no longer will qualify to receive charitable contributions. Donors likely will terminate gifts to nonqualifying organizations and will seek qualifying nonprofits in order to receive the charitable contribution deduction on donations of assets. For example, if a governmental unit significantly tightens the standards for tax exemption of organizations providing food for the poor but at the same time liberalizes or does not adjust the standards for tax-exempt status of organizations providing housing for the homeless, shifts in donations will result. The obvious recipients will be to the remaining tax-exempt organizations, the greater number of which will be organizations providing housing for the homeless. *See, e.g.*, Michele L. Robinson, *Labor Pains*, HEALTH SYSTEMS REV., July/Aug. 1996, at 18, 19; Lawrence W. Singer, *The Conversion Conundrum: The State and Federal Response to Hospitals' Changes in Charitable Status*, 23 AM. J.L. & MED. 221, 230 (1997); Gene Steuerle, *Just What Do Nonprofits Provide?*, 19 EXEMPT ORG. TAX REV. 373, 274 (1998).

71. 709 P.2d 265 (Utah 1985).

72. *See id.* at 269. The state's constitution provides that the property tax exemption is available to "property owned by a nonprofit entity which is used exclusively for religious, charitable, or educational purposes." UTAH CONST. art. XIII, § 2, ¶ (2)(c) (1895, amended 1982). Thid same quoted language appears in Utah's code. *See* UTAH CODE ANN. § 59-2-1101 (1997).

73. *Intermountain Health Care*, 709 P.2d at 269 (alteration in original) (citations omitted).

> donations, and payment from recipients) produces a "profit" to the entity in the sense that the income exceeds operating and long-term maintenance expenses; (5) whether the beneficiaries of the "charity" are restricted or unrestricted and, if restricted, whether the restriction bears a reasonable relationship to the entity's charitable objectives; and (6) whether dividends or some other form of financial benefit, or assets upon dissolution, are available to private interests, and whether the entity is organized and operated so that any commercial activities are subordinate or incidental to charitable ones.[74]

The court indicated two reasons for finding that the two hospitals did not provide the constitutionally required gift to the community and did not deserve tax-exempt status: (1) there was no relief of government burden because for-profit hospitals provided the same health care services; and (2) the hospitals failed to show that they were almsgivers or provided unpaid services because there was no substantial imbalance demonstrated between the value of the services provided to beneficiaries and payments received by the hospitals, apart from gifts, donations or endowments.[75] The court's majority focused in large part on the historical and economic contexts of that which had been considered "charitable" for health care organizations. Specifically, the majority opinion stated:

> Because the "care of the sick" has traditionally been an activity regarded as charitable in American law, and because the dissenting opinions rely upon decisions from other jurisdictions that in turn incorporate unexamined assumptions about the fundamental nature of hospital-based medical care, we deem it important to scrutinize the contemporary social and economic context of such care. We are convinced that traditional assumptions bear little relationship to the economics of the medical-industrial complex of the 1980s. Nonprofit hospitals were traditionally treated as tax-exempt charitable institutions because, until late in the 19th century, they were true charities providing custodial care for those who were both sick and poor. The hospitals' income was derived largely or entirely from voluntary charitable donations, not governmental subsidies, taxes, or patient fees. The function and status of hospitals began to change in the late 19th century; the transformation was substantially completed by the 1920s. "From charities, dependent on voluntary gifts, [hospitals] developed into market institutions financed increasingly out of payments from patients." The transformation was multidimensional: hospitals were redefined from social welfare to medical treatment institutions; their charitable foundation was replaced by a business basis; and their orientation shifted to "professionals, and their patients" away from "patrons and the poor."
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> The magnitude and character of the change in hospital care is suggested by a number of factors. . . .

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74. *Id.* at 269-70. For a discussion of these factors and the Utah Supreme Court opinion, see, for example, Jerry J. McCoy, *Health Care and the Tax Law: Reorganizations, Structural Changes, and Other Contemporary Problems of Tax-Exempt Hospitals*, 44TH ANNUAL N.Y.U. TAX INSTITUTE § 58.04 (1986), Phelon S. Rammell & Robert J. Parsons, *Utah County v. Intermountain Health Care: Utah's Unique Method for Determining Charitable Property Tax Exemptions—A Review of its Mandate and Impact*, 22 J. HEALTH & HOSP. LAW 73, 77-80 (1989), O'Donnell & Taylor, *supra* note 62, at 66, and Emge, *supra* note 62, at 618.

75. *See Intermountain Health Care*, 709 P.2d at 278.

> Also of considerable significance to our review is the increasing irrelevance of the distinction between nonprofit and for-profit hospitals for purposes of discovering the element of charity in their operations.[76]

While substantial changes in the nature of hospitals as health care providers had occurred over the years, the population needing hospital care still encompassed significant numbers of poor persons. As a means of declaring the then-current social value of providing free health care to this group of individuals, the Supreme Court of Utah asserted that Utah's constitutional provision must be heeded and must be an essential part of the criteria for nonprofit hospitals to obtain or retain a property tax exemption.

Subsequently, relying on language from court opinions, the Utah State Tax Commission (Commission) issued elaborate standards for property tax exemptions applicable to health care providers and other charitable organizations.[77] In doing so, the Commission reconfirmed the Utah Supreme Court's vision of current social needs by listing the same criteria for identifying "charitable purpose" generally[78] and specifically it added standards for determining tax exemption entitlement by health care providers.[79] The Commission broadened the Utah Supreme Court's definition of activities worthy of qualifying as a "gift" to the community by health care providers to encourage certain behaviors in addition to the provision of free health care. Standard V, applicable to health care providers, specifies that:

> [t]he institution . . . must establish that its total gift to the community exceeds on an annual basis its property tax liability for that year. The Utah Supreme Court has defined gift to the community as follows: "A gift to the community can be identified either by a substantial imbalance in the exchange between the charity and the recipient of its services or in the lessening of a government burden through the charity's operation." Utah County v. Intermountain Health Care Inc., 709 P.2d 265 (Utah 1985).
>
> The following quantifiable activities and services are to be counted towards the nonprofit entity's total gift to the community:
>
> • Indigent care—The reasonable value of the hospital's unreimbursed care to medically indigent patients. The term "medically indigent" refers generally to patients who are financially unable to pay the cost of the care they receive. . . .
>
> • Community education and service—The reasonable value of volunteer and community service (including education and research) rendered for and by the hospital or nursing home. . . .
>
> • Medical discounts . . . .
>
> • Donations of time . . . .

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76. *Id.* at 270-71 (alteration in original) (footnotes omitted).

77. *See* PROPERTY TAX DIV., UTAH STATE TAX COMM'N, PROPERTY TAX ADMIN. STANDARDS OF PRACTICE, [hereinafter STANDARDS OF PRACTICE], *Nonprofit Hospital and Nursing Home Charitable Property Tax Exemption Standards, Appendix D*, [hereinafter *Nonprofit Hospital Standards*], at 32 (unpublished) (specific standards for hospitals and nursing homes); STANDARDS OF PRACTICE, *supra, 16 Nonprofit Entities: Religious, Charitable and Educational* [hereinafter *Religious, Charitable and Educational Standards*] at 18 (standards applicable generally to charitable organizations). The Utah Supreme Court upheld the constitutionality of the STANDARDS OF PRACTICE, *supra* in Howell v. County Bd. *ex rel.* IHC Hosps., 881 P.2d 880 (Utah 1994).

78. *Religious, Charitable and Educational Standards, supra* note 68, § 16.1, at 19.

79. *Nonprofit Hospital Standards, supra* note 77, at 32-36.

> • Donations of money . . . .
>
> The institution's charitable gift to the community also includes the community value, whether or not precisely quantifiable, of (a) the operation of tertiary care units or other critical services or programs that may not otherwise be offered to the community, or (b) the continued operation of hospitals where revenues are insufficient to cover costs, such as a primary care hospital in a rural community.[80]

Clearly, with this supplemental list of activities, the Commission was attempting to orchestrate and foster new behavior patterns by new and established nonprofit hospitals and nursing homes and even perhaps to discourage the conversion of nonprofit hospitals to for-profit endeavors.

At approximately the same time as the *Intermountain Health Care* case, the Supreme Court of Pennsylvania, in *Hospital Utilization Project v. Commonwealth (HUP)*, considered the appropriate standard to be applied in determining sales and use tax exemption entitlement by a nonprofit provider of statistical analysis of patient treatment and cost data.[81] The court determined that exemption depended upon an organization's qualifying as a "purely public charity," as required by the Pennsylvania Constitution.[82] Although the term had not been defined "with

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80. *Nonprofit Hospital Standards*, *supra* note 77, at 34-35. In addition to Standard V, other specific criteria were established for health care related organizations, which in relevant part provide:

> Standard I: The health care organization must be organized on a nonprofit basis to (i) provide hospital or nursing home care; (ii) promote health care, or (iii) provide health related assistance to the general public. On dissolution, the institution's assets must be distributable only for exempt purposes under Utah law, or to the government for a public purpose.
>
> Standard II: None of the net earnings and no donations can inure to the benefit of private shareholders or other individuals, "as the private inurement standard has been interpreted under Internal Revenue Code § 501(c)(3) of the Internal Revenue Code." Comments: Compliance with Internal Revenue Code § 501(c)(3) creates a rebuttable presumption that NFP's operations are reasonable. . . .
>
> Standard III: Provides for nondiscrimination clauses and open access policies.
>
> Standard IV: The institution must . . . establish that its policies integrate and reflect the public interest. A rebuttable presumption of compliance with this standard is assumed if it is shown that (i) the institution's governing board has a broad based membership from the community served by the institution, as required by federal tax law; (ii) the institution confers at least annually with the county board of equalization or its designee concerning the community's clinical hospital needs that might be appropriately addressed by the institution; and (iii) the institution establishes and maintains a "charity plan" to ensure compliance with Standard III and Standard IV.
>
> Comments: Judicial decisions on property tax exemptions highlight the importance of charitable institutions contributing to the common good. In addition, the courts have indicated that charitableness must require an element of "gift" and has stated that such a gift may be met through the lessening of a governmental responsibility. In meeting this standard the membership and operation of governing boards is [sic] important. . . . There should also be a showing that exempt institutions seek to address the health care needs of the community. . . . Two important points of caution: First, the term "community" may well be narrower or broader than an individual county's geographic boundaries. . . . Second, all policy decisions relating to the governance and operation of the institution are ultimately under the direction of the institution's governing board. . . .

Id.

81. *See* Hospital Utilization Project v. Commonwealth, 487 A.2d 1306 (Pa. 1985).

82. *See id.* at 1311-12 (stating that for purposes of the state tax exemption available to charitable organizations, *see* 72 PA. CONS. STAT. ANN. § 7204 (West 1889), the concept of a purely public charity pursuant to the Pennsylvania constitution controls, *see* PA. CONST. art. VIII, § 2(a)(v), rather than the definition found in the

exactness under Pennsylvania law,"[83] the court found that for any nonprofit organization to be considered a "purely public charity," and therefore entitled to tax exemption, it must possess five characteristics: (1) it must advance a charitable purpose; (2) it must donate or render gratuitously a substantial portion of its services (provide a gift to the community); (3) it must benefit a substantial and indefinite class of persons who are legitimate subjects of charity; (4) it must relieve the government of some of its burden; and (5) it must operate entirely free from private profit motive.[84] The court found that the nonprofit organization failed all five requirements.[85] In commenting on the organization's failure to advance a charitable purpose, the court asserted that the organization did not provide a gift for general public use and was not charitable in the legal sense.[86] It failed to provide gratuitous services since it charged all patients fees approximately equal to its actual costs;[87] it did not serve a legitimate class because it served a definite number of hospitals and health care service facilities which "do not fall within the genre of the poor, incapacitated, distressed or needy;"[88] it did not relieve any government burden because its services were not traditionally undertaken by government;[89] and it did not demonstrate that it operated entirely free of profit motive.[90]

Similar to the Utah Supreme Court,[91] the Pennsylvania Supreme Court asserted the importance of perceived current social needs and a nonprofit's role in addressing those social needs in order to be considered deserving of a sales and use tax exemption.[92] Subsequently, the five *HUP* factors were applied to several Pennsylvania hospitals to determine whether they qualified as "purely public charities" entitled to property tax exemptions.[93] In each case, the characteristics were applied narrowly and the property tax exemptions were denied, obviously resulting in fewer tax-exempt hospitals.[94]

In response to the *HUP* case, the Pennsylvania legislature considered it important to clarify the standards required of a "purely public charity" worthy of tax exemption. On November 26, 1997, the Pennsylvania governor signed into law the

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administrative code of regulations, *see* 61 PA. CODE § 32.1 (1999)).

83. *Id.* at 1312. However, in making its list of the five relevant factors, the court drew upon a number of previously decided cases including *Appeal of Marple Newtown School District*, 455 A2d 98 (Pa. 1982); *Appeals of Woods Schools*, 178 A.2d 600 (Pa. 1962); *In re Hill School*, 87 A.2d 259 (Pa. 1952); *YMCA of Germantown v. Philadelphia*, 187 A.2d 204 (Pa. 1936).

84. *See HUP*, 487 A.2d at 1317.

85. *See id.* at 1317-18.

86. *See id.* at 1317.

87. *See id.*

88. *See id.*

89. *See id.* at 1317, n.10.

90. *See id.* at 1317-18.

91. *See* Utah County v. Intermountain Health Care, Inc., 709 P.2d 265 (Utah 1985).

92. *See HUP*, 487 A.2d at 1313-17.

93. *See* Pinnacle Health Hosps. v. Dauphin County Bd. of Assessment Appeals, 708 A.2d 845 (Pa. Commw. Ct. 1998); School Dist. of Erie v. Hamot Med. Ctr. of Erie, 602 A.2d 407 (Pa. Commw. Ct. 1992). Because the property tax exemption is available only to charitable organizations and depends on a state constitutional provision, *see* PA. CONST. art. 8, § (2)(a), the organization must be a "purely public charity." *Id.*

94. *See* Carolyn D. Wright, *Pennsylvania Court's Decision in Hospital Cases: Bad News, For Now*, 19 EXEMPT ORG. TAX REV. 328, 328 (1998). In both *Pinnacle Health Hospitals* and *Hamot Medical Center*, the Commonwealth Court determined that the hospitals failed to satisfy the fifth factor—the organization must operate entirely free of a profit motive—established in *HUP*.

Institutions of Purely Public Charity Act (IPPCA),[95] which, although utilizing the five *HUP* factors set forth in the 1985 case,[96] like the standards established by the Utah Commission, takes a broader approach to the definition of a "purely public charity." Focusing on behavior considered to be a gift to the community, the organization must donate or render gratuitously a substantial portion of its services, which the organization is deemed to meet if it satisfies one of the seven following objective tests:

> (1) It has a written policy, that is publicized in reasonable manner, that no one will be turned away because of inability to pay; it must provide uncompensated goods or services of the greater of 75% of net operating income or 3% of total operating expenses;
> (2) it implemented a written policy and fee schedule for basing charges on family income. At least 20% of those served must pay less than cost of services, and at least 50% of that group must receive a reduction that is at least 10% below cost. Below cost goods or services must be comparable to those provided to persons paying more than cost, or no one can be charged more than cost;
> (3) It provides free goods or services to at least 5% of persons receiving similar goods or services;
> (4) It provides either financial assistance or uncompensated goods and services to at least 20% of those served, provided half of the subsidized group pays fees of no more than 90% of cost;
> (5) It provides uncompensated goods or services that in the aggregate equal 5% of its costs of providing goods or services;
> (6) If the institution is a qualifying organization, provides goods or services free or at reduced rate to government agencies or individuals eligible for governmental programs; or
> (7) It engages in fund raising on behalf of or in making grants to other purely public charities, to entities "similarly recognized by another state or foreign jurisdiction," to qualifying religious organizations, or to government agencies.[97]

Moreover, the Pennsylvania legislature envisioned that the nonprofit organization additionally and separately must relieve the government of a burden as a quid pro

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95. Institutions of Purely Public Charity Act (IPPCA), Pub. L. No. 508 (1997) (codified at 10 PA. STAT. §§ 371-85 (1998)) (originating bill at 1997 Pa. H.R. 55, Pa. 81st Gen. Assembly (1997)).

96. Pursuant to the IPPCA, *supra* note 95, a "purely public charity" is one which, in addition to providing gratuitous services, satisfies the following: (1) charitable purpose test—the entity is organized and operated primarily for the relief of poverty; advancement and provision of education, including secondary education; advancement of religion; prevention or treatment of disease or injury, governmental or municipal purposes; or accomplishment of a purpose recognized as important and beneficial to the public and which advances social, moral or physical objectives; (2) private profit motive—the organization is free from private profit motive if none of the net earnings or donations inures to benefit of shareholders or other individuals as those standards are applied under the Internal Revenue Code § 501(c)(3)); the organization expends or reserves all revenue, including contributions, in excess of expenditures in furtherance of charitable purpose or to fund other institutions organized and operated for charitable purpose and operate free of private profit motive; and the governing instruments bar the use of surplus funds for private inurement of any person in event the organization is sold or dissolved; (3) charity to persons—benefit a substantial class of persons who are legitimate subjects of charity—This test requires that beneficiaries be unable to provide themselves with what the institution provides and the class not predetermined in number; (4) government service—relieve the government of a burden; and (5) provide gratuitous services. *See id.* (as codified at 10 PA. STAT. § 375).

97. *Id.* (as codified at 10 PA. STAT. § 375(D)(1)).

quo for the indirect subsidy of tax exemption.[98] Through its vision of how a nonprofit organization may satisfy its obligation to relieve a governmental burden, the legislature broadly defined public functions or services which are valued. To this end, the legislature established the following standard:

> The organization must satisfy one of the following tests in order to relieve the government of a burden: (A) It provides a service to the public that the government would otherwise be obliged to fund or to provide directly or indirectly or to assure that a similar institution exists to provide the service; (B) It provides services in furtherance of the organization's charitable purposes that are either the responsibility of government by law or historically have been assumed, offered or funded by government; (C) It receives payments for services on a regular basis under government program that are less than full cost of providing services; (D) It provides service to public that directly or indirectly reduces dependence on government programs or relieves or lessens the burden borne by government for the advancement of social, moral, educational, or physical objectives; (E) It advances or promotes religion and is owned and operated by a corporation or other entity as a religious ministry; or (F) It enters into a voluntary agreement with local governments.[99]

Both Utah's Commission and the Pennsylvania legislature constructed potentially quantifiable measures for determining whether specific activities are sufficient to constitute a "gift" of services. In doing so, these governmental bodies purposefully circumscribed the exemption criteria but broadened their respective supreme courts' more restrictive views. These intentional circumscriptions should prevent perceived abuses, should reduce opportunities for tax revenue losses and should foster certain patterns of socially desirable institutional behaviors by nonprofits to account for a world of changing social needs, but should not discourage the existence and possible growth of the nonprofits whose activities reflect those socially valued goods and services.[100]

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98. *See id.* (as codified at 10 PA. STAT. § 375(F)). This approach stands in contrast to the Utah State Tax Commission's approach that incorporates the relief of government burden as a means of satisfying the "gift" requirement. Regardless of the tact, the underlying notion is that charitable organizations which relieve the government of a burden are providing essential public services that the governmental unit otherwise would be responsible to deliver because the private market is not optimally delivering the services. In other words, the tax exemption is considered to be a means (albeit arguably not an efficient one) of defining governmental or public functions. According to this view, the government fosters worthy charitable purposes and organizations through an indirect subsidy, the tax exemption. The relief of the government burden is considered a quid pro quo for the tax exemption. *See* Ginsberg, *supra* note 40, at 311. For a discussion of the relief of government burden theory as applied in the federal income tax context, *see* Bittker & Rahdert, *supra* note 69, at 305; Robert S. Bromberg, *The Charitable Hospital*, 20 CATH. U. L. REV. 237, 241-56 (1970); Nina J. Crimm, *Developing an Explanation of the Federal Income Tax Exemption for Charitable Organizations: A Theory of Risk Compensation*, 50 FLA. L. REV. 419, 429 n.34 (1998); Mark A. Hall & John D. Colombo, *The Charitable Status of Nonprofit Hospitals: Toward a Donative Theory of Tax Exemption*, 66 WASH. L. REV. 307, 332-84 (1991). *See also supra* note 53(discussing the subsidy theory).

99. IPPCA, *supra* note 95 (as codified at 10 PA. STAT. § 375(F)) and accompanying text.

100. *See Western Pa. Hosps.*, *supra* note 48, at 18; Lucy Pantaleoni, Note, *New York's Real Property Tax Exemptions for Religious, Educational, and Charitable Institutions: A Critical Examination*, 44 ALBANY L. REV. 488, 502-503 (1980).

The IRS and federal courts have also recognized charity as an evolving concept. *See* John P. Persons et al., *Criteria For Exemption Under Section 501(c)(3), in* FILER COMM'N RESEARCH PAPERS, *supra* note 3, at 1909; Crimm, *supra* note 38, at 11-70.

IV. ORGANIZATIONAL BEHAVIORS

Strong deservedness and anti-abuse doctrines underlie tax exemptions for nonprofit organizations. These policies demand that nonprofits significantly and sufficiently contribute to societal needs—that is, for example, charitable organizations must engage "exclusively"[101] in charitable activities[102]—and in doing so, they must refrain from competitive behavior with for-profit entities.[103] When nonprofits have failed these behavioral requisites, they have become targets for challenge by state and local governments.[104]

As society has evolved and as charitable segments within the nonprofit sector have modernized, notions of the types of activities that constitute charity have changed. The traditional perception of relief of the poor and distressed is viewed as irrelevant, too narrow, or no longer necessarily applicable solely to charitable nonprofit organizations.[105] For-profit entities are considered legitimate entrants in

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101. The term "exclusively" is understood to mean "primarily." *See, e.g.*, Hospital Utilization Project v. Commonwealth, 487 A.2d 1306, 1315 (Pa. 1985) ("[A] 'purely public charity' does not cease to be such where it receives some payment for its services . . . ."); Utah County v. Intermountain Health Care, Inc., 709 P.2d 265, 269 (Utah 1985) (listing six factors to determine "exclusively").

102. Section 501(c)(3) of the Internal Revenue Code predicates the income tax exemption for charitable, educational, and religious organizations on their being "exclusively" organized and operated for the performance of behaviors consistent with those purposes. State and local tax exemptions have a similar requisite. *See, e.g.*, I.R.C. § 501(c)(3) (1994); ARK. CODE ANN. § 26-52-421 (Michie 1997); UTAH CODE ANN. § 59-2-1101 (1997).

103. The concept of noncompetition with for-profit organizations is the same as the commerciality doctrine that has been applied with respect to the federal income tax exemption for charitable, educational, religious and other such organizations. *See, e.g.*, D.C. CODE ANN. § 47-1802.1 (1997). There is a long line of case law and literature covering the application of the commerciality doctrine to the federal income tax exemption. *See* Better Bus. Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279, 283-84 (1945); Trinidad v. Sagrada Orden de Predicadores, 263 U.S. 578, 581-82 (1924); Sound Health Ass'n. v. Commissioner, 71 T.C. 158, 190 (1978); B.S.W. Group v. Commissioner, 70 T.C. 352, 358 (1978); James Bennett & Gabriel Rudney, *A Commerciality Test to Resolve the Commercial Nonprofit Issue*, 36 TAX NOTES 1095 (1987); Crimm, *supra* note 38, at 35-38; Bruce R. Hopkins, *The Most Important Concept in the Law of Tax-Exempt Organizations Today: The Commerciality Doctrine*, 5 EXEMPT ORG. TAX REV. 459 (1992).

The commerciality doctrine considers an activity conducted in a commercial manner to be inconsistent with the furtherance of an exempt purpose and hence the activity is considered nonexempt. The courts generally have viewed such activity from the perspective of the consumer and have suggested that if the activity cannot be differentiated from that of a for-profit counterpart organization, the activity is considered commercial in nature. *See In re* Evangelical Lutheran Samaritan Soc'y, 804 P.2d 299 (Idaho 1990); Institute of Gas Tech. v. Dept. of Revenue, 683 N.W.2d 484 (Ill. App. Ct. 1997); Paper Mill Playhouse v. Millburn Township, 472 A.2d 517 (N.J. 1984); Princeton Univ. Press v. Princeton, 172 A.2s 420 (N.J. 1961); Koenig v. Jewish Child Care Ass'n, 487 N.Y.S.2d. 759 (N.Y. App. Div. 1985); Muskigum Watershed Conservancy Dist. v. Walton, 257 N.E.2d 240 (Ohio 1970).

104. *See* Berton, *supra* note 8, at A1; Elsa Brenner, *The Fight Over Tax-Exempt Properties*, N.Y. TIMES, Aug. 11, 1996, at WC1, *available in* 1996 WL 7518991; Joe Fahy, *Anti-Tax Break Bill Worries Hospitals*, INDIANAPOLIS NEWS, Jan. 30, 1995, at A6, *available in* 1995 WL 3033055; *Leave Churches Untaxed*, *supra* note 44, at 79A; Ramsey & Shattuck, *supra* note 6, at 21; Edmund Sanders, *Nonprofit Health Care Questioned: Lawmakers Among Those Who Wonder If It Benefits Public*, SAN DIEGO UNION-TRIBUNE, Sept. 25, 1994, at I11, *available in* 1994 WL 5421710.

105. The traditional perception in large measure stemmed from legal distinctions between the nonprofit and the for-profit corporate forms. For-profit corporations, including hospitals, have an obligation to shareholders to maximize profits, but profit maximization generally would be inconsistent with the provision of charity care because furnishing free or below cost care would reduce profit potential. On the other hand, according to popular traditional notions (albeit incorrect because nonprofit corporations can make profits—called a surplus in traditional accounting terms) nonprofit entities, including hospitals, are not supposed to generate profits. *See Intermountain*, 709 P.2d at 270-72. This perception in part stemmed from legal prohibitions that arise from the structure of

this field of providing modern charitable activities. This new reality is especially true with respect to health care providers.

The current expectation is that both nonprofit and for-profit hospitals will provide some uncompensated care or charity care.[106] The studies are not entirely consistent, but there are statistics to indicate that the overall actual level of demand for "charity" care has diminished and that the uncompensated care provided by nonprofit hospitals for the most part may not be substantially distinguishable from that given by for-profit hospitals.[107] In large part this may be the result of changes

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nonprofit entities—that is, the prohibition against: (a) raising capital by offering equity interests; (b) disbursement of any revenues in excess of debt costs and production costs to members in the form of dividends, liquidated assets, or otherwise; (c) payment of surplus revenues to managers in excess of reasonable salaries; and (d) violating fiduciary duties to members and the public. People holding this view believe that nonprofit hospitals should be altruistic in nature, thereby requiring of them the provision of charity care to the poor. Moreover, the traditional perception is that the provision of charity care is a quid pro quo for the financial advantages provided by tax-exempt status. *See id.* at 268. Finally, although this view is changing or has changed, the common belief has been that nonprofit hospitals are not business enterprises and therefore should not compete with one another nor with for-profit hospitals for patients. *See* Kenneth J. Arrow, *Uncertainty and the Welfare Economics of Medical Care*, 53 AM. ECON. REV. 941 (1963); Carson W. Bays, *Why Most Private Hospitals Are Nonprofit*, 2 J. POL'Y ANALYSIS & MGMT. 366, 367-73 (1983); Kenneth W. Clarkson, *Some Implications of Property Rights in Hospital Management*, 15 J.L. & ECON. 363, 363-70 (1972); E.F. Fama & M.C. Jensen, *Agency Problems and Residual Claims*, 26 J.L. & ECON. 327 (1983); Richard W. Foster, *Hospitals and the Choice of Organizational Form*, 3 FIN. ACCOUNTABILITY & MGMT. 343, 343-49 (1987); Bradford H. Gray & Walter J. McNerney, *For-Profit Enterprise in Health Care: The Institute of Medicine Study*, 314 NEW ENG. J. MED. 1523, 1524-25 (1986); Stanley B. Jones et al., *Competition or Conscience? Mixed-Mission Dilemmas of the Voluntary Hospital*, 24 INQUIRY 110, 113-18 (1987) [Editor's Note: the health care journal, not the philosophy journal]; Theodore R. Marmor et al., *A New Look at Nonprofits: Health Care Policy in a Competitive Age*, 3 YALE J. ON REG. 313, 315-17 (1986); Mark V. Pauly, *Nonprofit Firms in Medical Markets*, AEA PAPERS AND PROCEEDINGS, May 1987, at 257-60; Mark Schlesinger et al., *Nonprofit and For-Profit Medical Care: Shifting Roles and Implications for Health Policy*, 12 J. HEALTH POL., POL'Y & L. 427, 427-29 (1987). The role of churches and other non-health care charitable organizations in furnishing a social safety net has also been questioned. *See* Pertman, *supra* note 8, at 1.

106. Numerous studies and articles have been produced concerning three issues: (a) finding a suitable definition of "charity care" for nonprofit hospitals; (b) determining the appropriate amount of charity care to be deserving of tax-exempt status; and (c) agreeing upon the means of measuring whether the obligation of providing charity care has been satisfied. The debate is complicated by a disagreement over the definitions of key terms. Some scholars have equated the terms "charity care" and "uncompensated care." Others have grouped "uncompensated care" as a subset of the larger term "bad debt." Bad debt results from underpayment of hospital charges by financially-able patients. The measurement of both terms has been determined to be imperfect because it is capable of being both under-inclusive and over-inclusive. *See* Susan M. Sanders, *Does Mission Really Matter? Measuring and Examining Charity Care and Community Benefit in Nonprofit Hospitals*, *in* HEALTH INSURANCE AND PUBLIC POLICY 87-89 (M.K. Mills & R.H. Blank eds., 1992); Frank A. Sloan et al., *Identifying the Issues: A Statistical Profile*, *in* UNCOMPENSATED HOSPITAL CARE: RIGHTS AND RESPONSIBILITIES 16 (Frank A. Sloan et al. eds., 1986); Barbara Arrington & Cynthia Carter Haddock, *Who Really Profits from Nonprofits?*, 25 HEALTH SERV. RESEARCH 291 (1990); Gray & McNerney, *supra* note 105, at 1523; Regina E. Herzlinger, Letter to the Editor, *Are Voluntary Hospitals Caring for the Poor?*, 319 NEW ENG. J. MED. 1485-86 (1988); Regina E. Herzlinger & William S. Krasker, *Who Profits from Nonprofits?*, HARV. BUS. REV., Jan.-Feb. 1987, at 93; Lawrence S. Lewin et al., *Setting the Record Straight: The Provision of Uncompensated Care by Nonprofit Hospitals*, 318 NEW ENG. J. MED. 1212 (1988); Suzanne Mulstein, *The Uninsured and the Financing of Uncompensated Care: Scope, Costs and Policy Options*, 21 INQUIRY 214 (1984); Uwe E. Reinhardt, *Flawed Methods Cripple Study on Nonprofits*, HOSPITALS, Apr. 20, 1987, at 136; Susan M. Sanders, *Measuring Charitable Contributions: Implications for the Nonprofit Hospital's Tax-Exempt Status*, 38 HOSP. & HEALTH SERV. ADMIN. 401 (1993); Bruce Steinwald & Duncan Neuhauser, *The Role of the Proprietary Hospital*, 35 LAW & CONTEMP. PROB. 817 (1970). *See generally* INSTITUTE OF MEDICINE, FOR-PROFIT ENTERPRISE IN HEALTH CARE (1986).

107. See Stephen M. Shortell et al., *The Effects of Hospital Ownership on Nontraditional Services*, HEALTH AFFAIRS, Winter 1986, at 101-102 (discussing system hospitals); Jay Woltson, *Overcoming Challenges to Tax-Exempt Status*, HEALTH CARE FIN. MGMT., Apr. 1996, at 58. Commentators and studies continue to differ: (a) on the aggregate amount of charity care that nonprofit hospitals, as opposed to for-profit hospitals, provide; (b) whether the poor actually receive charity care; (c) the characteristics of hospitals supplying the greatest amount of

in Medicare, Medicaid and private insurance programs.[108] It has been suggested that these programs may have reduced considerably the traditional role of nonprofit hospitals, have lessened their important historical social benefit function, and have enhanced competitiveness between nonprofit and for-profit hospitals.[109]

In the process of nonprofit hospitals' becoming more competitive with for-profit hospitals,[110] public perception has evolved.[111] The public's attitude now appears to functionally equate nonprofit and for-profit hospitals (and perhaps other nonprofit and for-profit health care providers). This change may have been fueled in part by the proliferation of mergers, acquisitions, joint ventures and conversions of nonprofit hospitals, HMOs and other health care providers into for-profits.[112] As this trend has occurred, the for-profit sector of health care providers has grown.[113] In

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charity care; and (d) the impact of charity care on a hospital's efficiency or inefficiency. *See* UNITED STATES GENERAL ACCOUNTING OFFICE: REPORT TO THE CHAIRMAN, HOUSE OF REPRESENTATIVES SELECT COMMITTEE ON AGING, NONPROFIT HOSPITALS—BETTER STANDARDS NEEDED FOR TAX EXEMPTION 21-29 (1990); UNITED STATES GENERAL ACCOUNTING OFFICE: REPORT TO THE HONORABLE SAM NUNN, UNITED STATES SENATE, PUBLIC HOSPITALS: SALES LEAD TO BETTER FACILITIES BUT INCREASED PATIENT COSTS 38-49 (1986); Pearl Richardson, *Congressional Budget Office Report, Health Care Trends and the Tax Treatment of Health Care Institutions*, 10 EXEMPT ORG. TAX REV. 897, 910-13 (1994); Kenneth E. Thorpe & Charles E. Phelps, *The Social Role of Not-For-Profit Organizations: Hospital Provision of Charity Care*, 29 ECON. INQUIRY 472 (1991).

108. *See* Davis, *supra* note 38, at 10-103 (generally discussing medicare and medicaid programs); *Strong Cash Flow, Balance Sheet, Management, Key to Capital Needs*, 39 J. HEALTHCARE FIN. MGMT. 48 (1985); *What Ails the Hospital Managers?*, INSTITUTIONAL INV., Nov. 1983 at 341; Bill Neikirk, *Who Picks Up the Health Tab the U.S. Dropped?*, CHICAGO TRIBUNE, June 22, 1986, at 1, *available in* 1986 WL 2678391.

109. *See Western Pa. Hosps.*, *supra* note 48, at 75-76; Crimm, *supra* note 38, at 9-11; Gray, *supra* note 45, at 3; Curt A. Kramer, *Nonprofit Hospitals: A Charitable Cause or an Unjustified Tax Subsidy?*, 3 EXEMPT ORG. TAX REV. 341, 349 (1998); Potter & Longest, *supra* note 62, at 415.

110. *See* James Brown, *View From the Hills*, 27 AM. FAM. PHYSICIAN, 381 (1983); Joe Flower, *Is the War Between Investor-Owned Institutions and Not-For-Profits Over?*, 40 HEALTHCARE FORUM J. 59 (1997); T.J. Sullivan, *A Critical Look at Recent Developments in Tax-exempt Hospitals*, 23 J. HEALTH & HOSP. L. 65 (1990); Hal Bernton, *Competition Therapy: The Nation's Largest For-Profit Hospital Chain Takes on Alaska's Nonprofit Health Care Giant*, ANCHORAGE DAILY NEWS, Oct. 8, 1995, at 1C, *available in* 1995 WL 14720976; Brad Smith, *Competition Reshapes Nonprofit Health Care*, DENVER BUS. J., May 24, 1996, at 2C. *See generally* BRADFORD H. GRAY, THE PROFIT MOTIVE AND PATIENT CARE: THE CHANGING ACCOUNTABILITY OF DOCTORS AND HOSPITALS (1991) (examining the growth of profit seeking in American health care and the re-engineering of nonprofit hospitals in the image of for-profit counterparts). For a brief overview and background that led to the competition among hospitals, see J. Michael Woolley, *How Hospitals Compete: A Review of the Literature*, 2 U. FLA. J. L. & PUB. POL'Y 57 (1988-1989).

111. *See* Reed Abelson, *Suddenly Nonprofit Work Gets Profitable*, N.Y. TIMES, Mar. 29, 1998, at A1, *available in* 1998 WL 5404979; David R. Olmos, *A Dose of Reality; Greed Is Among Woes HMO Clients Must Contend With, Doctor Writes*, L.A. TIMES, Aug. 29, 1997, at D2, *available in* 1997 WL 2242197.

112. *See* DOUGLAS M. MANCINO, TAXATION OF HOSPITALS AND HEALTH CARE ORGANIZATIONS 11-1, -2 (1995 & Supp. 1997); John F. Coverdale, *Preventing Insider Misappropriation of Not-For-Profit Health Care Provider Assets*, 73 WASH. L. REV. 1 (1998). In 1995, Columbia/HCA acquired 33 formerly tax-exempt hospitals. In 1996, 17 of Columbia/HCA's acquisitions or joint ventures involved tax-exempt hospitals; an additional 14 acquisitions were pending. *See* Bruce Japsen, *Another Record Year for Dealmaking: Activity Among Medium-Size Companies Fuels Continued Drive Toward Consolidation*, MOD. HEALTHCARE, Dec. 23, 1996, at 37. In 1995, 48 nonprofit hospitals converted or planned to convert to for-profit status; this conversion trend seemingly slowed slightly in 1996. *See Demise of the Not-for-Profit Has Been Greatly Exaggerated*, MOD. HEALTHCARE, Dec. 23, 1996, at 35. As of 1996, one percent of all nonprofit hospitals had converted to for-profit status and 33% of HMOs had converted. *See* Bradford H. Gray, *HMOS and Hospitals: What's at Stake?*, 16 HEALTH AFFAIRS 29, 29-47 (1996).

113. *See* Angela Gonzales, *Funding of For-Profit Hospices Questioned*, BUS. J., Nov. 29, 1996, at 7; *Hospital Mergers: For-Profit Ventures Generate Backlash*, HEALTH LINE, Oct. 18, 1996, at 1; Monica Langley and Anita Sharpe, *Acute Reaction: As Big Hospital Chains Take Over Nonprofits, A Backlash Is Growing*, WALL ST. J., Oct. 18, 1996, at A1, *available in* 1996 WL-WSJ 11802751; Todd Varness et al., *Med Students Stand Tall for Patients, Not for Profits: Maryland Committee is Formed to "Defend Healthcare"*, BALTIMORE SUN, Dec. 7,

turn, this growth has provided clear evidence that health care can be a commercial, competitive business.[114]

The bottom line is that the public is less willing or is unable to distinguish between many nonprofits and for-profits. The magnitude and sources of revenues received by nonprofit organizations may contribute to this perception. It has been asserted that:

> Since 1975, nonprofits' revenues have climbed from 5.9% of the nation's income to more than 10%. Indeed, revenue for nonprofits, including community hospitals, service groups, educational institutions, Red Cross and elderly housing, but not churches and private foundations, was less than $100 billion back then, equal to what tax collectors gathered for local services. Now, those nonprofits' revenues exceed a half-trillion [dollars]—$100 billion more than local governments collect.[115]

Not only has the publicity of these occurrences and dollar figures been noticed by the general public, it also has drawn the attention of interest groups and politicians.[116] This has led to changes in the political and regulatory climate for nonprofit health care providers,[117] with greater efforts being expended on regulatory and enforcement matters.[118] For example, conversions of nonprofit HMOs to for-profit status have drawn legislators' attention. Perceived abuses have engendered new legislation and processes of notification and approval of the conversion by state agencies.[119] Some states have virtually banned conversions by passing strict and complicated disclosure requirements.[120] As of December 1997, eleven states and the District of Columbia had enacted statutes to regulate nonprofit conversions to for-profits; ten states had such legislation pending and similar legislation was pending before Congress; while in five states the governors had vetoed bills or such measures had died in committee.[121]

The attorney general's responsibility for being the guardian for the welfare of charitable organizations and their intended beneficiaries has been poorly executed over the years. This may be attributable to personnel constraints, the stress of more important duties, the lack of full information about nonprofit organizations within

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1997, at 6F, *available in* 1997 WL 5543038 (stating that between 1990 and 1995, for-profit HMOs grew 15-fold in market value and membership).

114. *See* Gray, *supra* note 45, at 3. *See generally* Gray, *supra* note 110 (generally examining the large and growing role of profit seeking in the American health care sector). The same view might be held with respect to other nonprofits.

115. *Taxpayers Deserve a Break from Churches*, *supra* note 44, at 14A.

116. *See* Gray, *supra* note 45, at 3; Roy Whitehead, Jr. & James H. Packer III, *States React to Not-for-Profit Hospital Conversions*, HEALTHCARE FIN. MGMT., Dec. 1997, at 58.

117. *See* Gallagher, *supra* note 2, at 25.

118. *See supra* note 1 and accompanying text; Cynthia Wallace, *HMOs Converting to For-Profit Status Could Face More Rigorous Reviews*, MOD. HEALTHCARE, Apr. 11, 1986, at 42; Roy Whitehead, Jr. et al., *Avoiding State Intervention in Not-For-Profit/For-Profit Affiliations*, HEALTHCARE FIN. MGMT., Dec. 1997, at 56-58 (indicating that attorneys general recently have intervened in transactions involving attempts by nonprofit health care providers to convert to or transfer assets to for-profits health care organizations).

119. *See, e.g.*, CAL. HEALTH & SAFETY CODE § 1399.72 (West Supp. 1997); NEB. REV. STAT. § 71-20, 104 (1996).

120. *See, e.g.*, N.Y. PUB. HEALTH LAW § 2801(a)(4) (McKinney 1993). *See* Whitehead & Packer, *supra* note 116, at 58.

121. *See id.*

his or her jurisdiction,[122] political pressures that attach to the position as a political officer and the infrequency of public complaints about particular nonprofit organizations.[123] Despite the fact that for many years neither attorneys general nor other appropriate government officials have been able to aggressively or adequately monitor nonprofit organizations, some states' attorneys general recently have increased scrutiny of these organizations and transactions, in response to the new health care environment of mergers, acquisitions, joint ventures and conversions. These newly assumed duties include matters that had been, perhaps by personnel necessity, primarily of concern to the IRS or the Department of Justice. Attorneys general now have an interest, as parens patriae, in exercising their legal obligations to protect fiduciary duty standards, to guard community benefit guidelines and to defend against antitrust potential violations.[124] This scrutiny is leading to more and more litigation.[125] A current New York case,[126] involving an action with potential

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122. In the early 1980s, officials from the Treasury Department, IRS, National Association of Attorneys General, and the National Association of State Charity Officials revamped the Federal Return of Organization Exempt from Income Tax, Form 990. As modified, the Form 990, filed annually with the IRS by nearly all 501(c)(3) organizations that are not private foundations, requires disclosure of financial information for accountability purposes. Form 990 is considered by Treasury and the IRS as essential for federal tax purposes and by state government officials as helpful in monitoring charities for obvious abuses and in regulating those charities that solicit funds within a state. Currently most states require charitable organizations to file the Form 990, and some states even require additional financial materials. *See* Peter Swords, *The Form 990 As An Accountability Tool for 501(c)(3) Nonprofits*, 51 THE TAX LAWYER 571, 577 (1998) (questioning the adequacy and effectiveness of the Form 990 as an accountability tool). New disclosure rules under I.R.C. § 6104(e) (as amended by Taxpayer Bill of Rights 2, Pub. L. No. 104-168, § 1313(a), 110 Stat. 1474 (1996) (codified in scattered sections of 26 U.S.C.)), require a federally tax-exempt organization to provide a copy of its Form 990 information return within 30 days of a written request. This change is expected to "lead to greater interest by the public in the finances and activities of exempt organizations." Fred Stokfeld, *Disclosure Rules Will Increase Public Interest in Form 990, Owen Says*, 21 EXEMPT ORG. TAX REV. 9 (1998) (paraphrasing IRS Exempt Organizations Division Director Marcus S. Owens' comments at a Washington conference). The public's inspection may promote yet more interest in these organizations by state tax authorities and attorneys general.

123. *See* Billitteri, *supra* note 1, at 34; George Gleason Bogert, *Proposed Legislation Regarding State Supervision of Charities*, 52 MICH. L. REV. 633, 634-35 (1954) (citing ELEANOR TAYLOR, PUBLIC ACCOUNTABILITY OF FOUNDATIONS AND CHARITABLE TRUSTS 143 (1953); State Attorney General D'Amours, The Control of Charitable Trusts by the Attorneys General, Address Before the Annual Meeting of the National Association of Attorneys General (1986), *in* PROCEEDINGS OF THE NATIONAL ASSOCIATION OF ATTORNEYS GENERAL 98 (1946); *State Regulation of Charitable Trusts and Solicitations*, *in* THE NATIONAL ASSOCIATION OF ATTORNEYS GENERAL COMMITTEE ON THE OFFICE OF ATTORNEY GENERAL, Aug. 1977, at 3, 6-7; Justice Fred R. Winans & Joseph G. Rimlinger, *Charitable Trusts in South Dakota: Who Shall Supervise Their Trustees?*, 21 S.D. L. REV. 232, 238 (1976); State Attorney General O'Neill, Address Before Montgomery Bar Association (1953); and sources cited *supra* note 3.

124. *See, e.g.*, Kelley v. Michigan Affiliated Health Corp, No. 96-83848-CZ (Mich. Cir. Ct. filed Sept. 5, 1996) (sustaining the attorney general's challenge to block the merger of a nonprofit health care provider and Columbia/HCA Healthcare Corporation on the grounds that the merger would violate fiduciary duties and betray the charitable trust); State v. Blue Cross and Blue Shield Mutual of Ohio, No. 311632 (Ohio C.P. filed July 11, 1996) (dealing with issues of violation of fiduciary duty of officers and directors); Cynthia Wallace, *supra* note 118, at 42; Attorney General Dan Lungren, *News Release*, CAL. DEP'T OF JUST., Nov. 8, 1996 (warning that if a proposed merger occurred, an action against the directors would be brought). Even outside the confines of mergers, acquisitions and conversions, attorneys general have increasingly monitored nonprofit health care organizations. *See, e.g.*, Attorney Gen. v. Hahnemann Hosp., 494 N.E. 2d 1011 (Mass. 1986) (scrutinizing nonprofit hospital's expanded purpose under cy pres doctrine to determine if it still conformed to original purpose established in charitable trust); Tennessee *ex rel.* Adventist Health Care Sys. v. Nashville Mem'l Hosp., Inc., 914 S.W.2d 903 (Tenn. Ct. App. 1995) (denying injunction request to stop the sale of nonprofit to a for-profit hospital); Robert Boisture & Douglas Varley, *State Attorneys General's Legal Authority to Police the Sale of Nonprofit Hospitals and HMOs*, 13 EXEMPT ORG. TAX REV. 227 (1996).

125. *See* Allison Bell, *New Jersey Blue Loses Charity Status Battle*, NAT'L UNDERWRITER, Feb. 16, 1998,

significant antitrust implications for hospital affiliations throughout the country, may foreshadow what will happen in the future.

V. DISTRUST AND SCANDAL

"Asleep on the Watch? . . . A Spate of Charity Scandals Raises Questions About the Effectiveness of Government Watchdog Agencies"[127] captures the flavor of many recent article titles. Negative press about nonprofit organizations and their fiduciary representatives—trustees, board members, officers and high-level executives—has flourished during the last twenty-five years. As suggested by one prior IRS official years ago, there are "a tremendous number of calls from reporters who have unearthed scandals or things they call scandals, and very often they're digging in the exempt organizations because exempt organizations are in a goldfish bowl—the reporters can find out more about them than they can about corporations or individuals."[128] In recent years, the media has reported fraud and abuse charges, such as misappropriation of funds. Salaries and benefits paid to officers and top executives of charitable organizations and self-dealing abuses have attracted newspaper coverage throughout the country.[129] Journalists reported that the Christian Broadcasting Network and its head, Pat Robertson, used the organization's money to promote Robertson's 1988 bid for the presidency.[130] Reports appeared about certain payments to John Silber, former president of Boston University,[131] and about excess compensation payments to and mismanagement by Peter Diamandopoulos, former president of Adelphi University,[132] and William

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at 2; *California Attorney General Opposes Sharp Hospital Deal with Columbia/HCA*, HEALTH LAW REP. (BNA) No. 45, at 1668 (Nov. 14, 1996).

126. *See* New York v. Saint Francis Hospital, No. 98-0939 (S.D.N.Y. filed Feb. 10, 1998) (hearing allegations by the New York attorney general of illegal price fixing and market allocation by two hospitals). New York, along with Massachusetts and Connecticut, are generally considered some of the most active states for purposes of monitoring and regulating charitable organizations.

127. Elizabeth Greene & Grant Williams, *Asleep on the Watch? . . . A Spate of Charity Scandals Raises Questions About the Effectiveness of Government Watchdog Agencies*, CHRON. PHILANTHROPY, July 27, 1995, at 1 (discussing the "Ponzi"-type scheme of the Foundation for New Era Philanthropy debacle, the NAACP abuses and the United Way scandal).

128. Abernathy & Saasta, *supra* note 33, at 35.

129. *See* Susan Gray & Elizabeth Greene, *Big Salaries Just Keep Going Up—Major Charitable Groups Continue to Pay Well to Lure Top Executives in Spite of Scandal and Scrutiny*, CHRON. PHILANTHROPY, Sept. 7, 1995, at 1; Douglas Lederman, *Private Colleges' Pay: A "Chronicle" Survey*, CHRON. HIGHER EDUC., Sept. 29, 1995, at A23.

130. *See Christian Broadcasting Network, IRS Reach Settlement*, 78 TAX NOTES 1598 (1998); Thomas B. Edsall, *Christian Network to Pay IRS Fine; Millions Were Spent to Promote Pat Robertson's '88 Campaign*, WASHINGTON POST, Mar. 21, 1998, at A1, *available in* 1998 WL 2474320; David Stout, *Christian Broadcasting Network to Pay Fine for Its Political Efforts in 1988*, N.Y. TIMES, Mar. 21, 1998, at A1, *available in* 1998 WL 5402915.

131. *See* Stephen Kurkjian, *'90 Silber IRS Filing Cites Additional Tax*, BOSTON GLOBE, Jan. 12, 1993, at 27, *available in* 1993 WL 6575943; *Presidents' Pay at Private Universities*, CHRON. HIGHER EDUC., Sept. 29, 1995, at 1 (reporting Silber's pay and benefits in 1993-1994 at $564,020, purportedly the highest pay provided at universities participating in survey); Wayne Woodlief, *Silber to Reveal Tomorrow if He'd Face Weld Again*, BOSTON HERALD, Jan. 18, 1994, at 16, *available in* 1994 WL 5377579.

132. *See* Greene & Williams, *supra* note 127, at 1; William H. Honan, *Best-Paid College Leader is At Northeastern U.*, N.Y. TIMES, Oct. 19, 1997, at 3, *available in* 1997 WL 8007886; Bruce Lambert, *State Sues to Recover Funds Spent by Adelphi's Ex-Trustees*, N.Y. TIMES, Mar. 25, 1997, at B1, *available in* 1998 WL 7989918 (also discussing the mismanagement by Adelphi trustees); Scot Lehigh, *Living with a Lot, Living with a Little*, BOSTON GLOBE, July 9, 1997, at D3, *available in* 1997 WL 6260573; *Ousted Adelphi Leaders Lose Preliminary*

Aramony, former president of the United Way.[133] Embezzlement and fraud involving millions of dollars were reportedly perpetrated on Goodwill Industries.[134] The use of for-profit subsidiaries by nonprofit organizations' fiduciary representatives as a means of splitting their compensation packages between for-profits and nonprofits to avoid disclosure problems has been recounted in the media.[135] Although it is known that the vast majority of nonprofit organizations and their fiduciary representatives engage in appropriate and honest dealings, these and other widely publicized abuses thrust the independent sector into the public limelight. It is only natural that these reports would inflame citizens who would pressure state attorneys general to subject nonprofit organizations to more critical scrutiny.

Granted, the behaviors of individual nonprofit institutions, their fiduciary representatives, and the independent sector have triggered renewed public activism and awareness by attorneys general. The behavior of the IRS also has contributed to the heightened interest. The IRS has come under visible scrutiny by politicians, the media and the public for alleged mishandling of taxpayer matters. In September 1997, public hearings were held before the Senate Finance Committee in which tales of IRS perceived abuses were told by taxpayers.[136] In response, in October 1997, Congressman Bill Archer introduced a bill calling for the restructuring of the IRS.[137] More hearings were held in 1998 before the Senate Finance Committee during which IRS problems were described further.[138] The House and Senate have since passed the Internal Revenue Service Restructuring and Reform Act of 1998,

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Rulings, N.Y. TIMES, Apr. 10, 1998, at B5, *available in* 1998 WL 5406924.

133. *See* Editorial, *Aramony's Fraud on United Way*, ATLANTA CONSTITUTION, Apr. 6, 1995, at A14, *available in* 1995 WL 6511912; Andrew Glass, Editorial, *Aramony Let Down the Needy*, ATLANTA CONSTITUTION, Mar. 7, 1992, at A19, *available in* 1992 WL 4577250; *United Way Chief Quits Among Scandal*, CHICAGO SUN-TIMES, Feb. 28, 1992, at 6, *available in* 1992 WL 3452406; Editorial, *United Way: Leaner and Needier*, N.Y. TIMES, Dec. 17, 1992, at A34, *available in* 1992 WL 2071907; *Voices: Would You Give to United Way? Or Are There Better Ways to Give?*, USA TODAY, Apr. 5, 1995, at A8, *available in* 1995 WL 2934059.

134. *See* Thomas J. Billitteri, *Goodwill Looting: California Scam Yields Lessons for Charity Managers*, CHRON. PHILANTHROPY, Feb. 12, 1998, at 39.

135. *See* Reed Abelson, *Charities Use For-Profit Units to Avoid Disclosing Finances*, N.Y. TIMES, Feb. 9, 1998, at A1, *available in* 1998 WL 5397459 (giving information on such charities as Minnesota Public Radio, Feed the Children, and the Cystic Fibrosis Foundation).

136. *See Hearings on the IRS Before the Senate Fin. Comm.*, 105th Cong. (Sept. 24, 1997), *available in* 1997 WL 591242 (taxpayer testimony); *Hearings on the IRS Before the Senate Fin. Comm.*, 105th Cong. (Sept. 25, 1997), *available in* 1997 WL 594068 and 1997 WL 603244 (IRS workers testified about the ills in the IRS).

137. *See* H. R. Rep. No. 105-599 (1998) (reporting on Archer's bill, H.R. 2676, 105th Cong. (1998) (enacted), entitled Internal Revenue Service Restructuring and Reform Act of 1998) [hereinafter IRS Restructuring Act]. The IRS Restructuring Act contains numerous provisions relevant to the oversight and restructuring of the IRS. It creates an outside board to oversee the IRS and the strengthening of taxpayers' rights. This board (composed of eleven members with eight of them being private citizens), without having the right to establish tax policy, has the right to submit an annual budget request to Congress on behalf of the IRS and to approve the IRS's strategic plans, the IRS's operations and performance of senior managers, and major reorganization of the IRS. Numerous changes were made with respect to taxpayer rights (this portion is known as the Taxpayer Bill of Rights 3). Among the major modifications of the Taxpayer Bill of Rights 3 are the shifting of the burden of proof to the IRS in tax matters in controversy before the United States Tax Courts, relief for innocent spouses, protections for taxpayers subject to audit or collection and the establishment of an easier means by which taxpayers may recover legal costs in cases where the IRS is found incorrect and by which taxpayers may win damages when the IRS is found to have acted negligently.

138. *See Hearings on the IRS Before the Senate Fin. Comm.*, 105th Cong. (Apr. 30, 1998), *available in* 1998 WL 219882.

and President Clinton signed it into law.[139] IRS Commissioner Charles Rossotti is designing and implementing plans for drastic structural changes for the agency.[140]

During this same general time period, the media carried other news stories that reflected poorly on the IRS. Newspaper reports told of the IRS's landmark reversal of its previous decision that the Church of Scientology was a commercial enterprise and did not deserve tax-exempt status.[141] The reversal granted tax-exempt status to over one hundred Church of Scientology-related entities, including the mother church. Moreover, the IRS agreed to stop auditing a number of the church's major organizations and to drop attempts to obtain certain church records. This and other concessions by the IRS were made after the Church of Scientology agreed to pay the federal government $12.5 million, which was intended to cover the church's payroll, income and estate tax bills for an undisclosed number of years prior to 1993.[142] Many experts in the tax community reeled. German government officials, whom the Church of Scientology had been pressing for tax-exempt status and had accused of harassment and discrimination, responded that "Scientology was not a church worthy of tax exemption, but a commercial enterprise."[143]

The IRS repeatedly has been criticized and discredited in the media by politicians and the general public. It is possible that a sense of distrust has resulted, heightening state authorities' alertness to matters previously entrusted to the IRS. Thus, for issues involving the tax-exempt status of a nonprofit organization, the states now might be reticent to rely exclusively on the IRS's judgment, findings and processes.

VI. GROWTH OF NONPROFIT SECTOR

Nonprofits may be triggering the attention of the attorneys general and state and local tax authorities for another straightforward reason: the sheer size and dramatic growth of the nonprofit sector during the past several decades. There were 806,375 nonprofit organizations that were tax-exempt under the Internal Revenue Code in 1978, and by 1992, there were over one million.[144] Between 1975 and 1990, the assets of these tax-exempt organizations rose over 150% in real terms and their revenues grew over 225% to approximately $560 billion.[145] As of 1990, tax-exempt organizations accounted for approximately 10% of the country's gross domestic

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139. *See* Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105-206, 112 Stat. 685 (1998) (codified as amended in scattered sections of 5, 23, 26, 38 U.S.C.).

140. *See* Tracey L. Miller, *Rossotti Unveils Plan to Overhaul, Cut IRS*, 12 ACCOUNTING TODAY 1 (1988).

141. *See* Douglas Frantz, *Scientology's Puzzling Journey From Tax Rebel to Tax-Exempt*, N.Y. TIMES, Mar. 9, 1997, at A1, *available in* 1997 WL 7987286; Douglas Frantz, *$12.5 Million Deal With I.R.S. Lifted Cloud Over Scientologists*, N.Y. TIMES, Dec. 31, 1997, at A1, *available in* 1997 WL 17837815; Elizabeth MacDonald, *Scientologists and IRS Settled for $12.5 Million: Accord in 1993 Also Called for Church to Set Up Tax Compliance Panel*, WALL ST. J., Dec. 30, 1997, at A12, *available in* 1997 WL-WSJ 14179025; *Scientology Agreement with IRS Comes to Light*, CHRON. PHILANTHROPY, Jan. 15, 1998, at 47.

142. *See* Frantz, *$12.5 Million Deal*, *supra* note 141, at A1; MacDonald, *supra* note 141, at A12.

143. Frantz, *Scientology's Puzzling Journey*, *supra* note 141, at A30; Frantz, *Scientology's Star Roster Enhances Image*, N.Y. TIMES, Feb. 13, 1998, at A1, A13, *available in* 1998 WL 5397736.

144. *See* UNITED STATES GENERAL ACCOUNTING OFFICE BRIEFING REPORT TO CONGRESSIONAL REQUESTERS, TAX-EXEMPT ORGANIZATIONS—INFORMATION ON SELECTED TYPES OF ORGANIZATIONS 8-9 (1995), *available in* 1995 WL 237385. The I.R.C. § 501(c)(3) organizations are the largest category of tax-exempts. *See id.* In 1990, of a total of 1,022,223 tax-exempt organizations, 489,891 were I.R.C. § 501(c)(3) charities. *See id.*

145. *See id.*

product, up from close to 6% in 1975.[146] In 1995, the nation's 1.1 million tax-exempt nonprofits generated approximately $1.1 trillion in revenues and controlled $1.475 trillion in assets.[147] By 1996, these tax-exempt organizations had revenues of $621.4 billion, up from $111.1 billion in 1977.[148] These dramatic changes have profoundly increased the visibility of the nonprofit sector in this country, and as with many visible and apparently productive industries in the American economy, scrutiny has followed.

CONCLUSION

Numerous economic and non-economic considerations account for the heightened attention state and local governmental officials have showered on nonprofit organizations during the last twenty-five years. These have included: (a) the increased size and visibility of the nonprofit sector; (b) a revitalization of federalism; (c) a search for new tax revenue sources by financially needy jurisdictions which have been subjected to recessionary stresses and tax base erosion; (d) the passage and implementation of regulatory and legislative initiatives to direct efforts and funds to changing social needs; (e) the perception that some charitable organizations' behavior demonstrates unworthiness of tax-exempt status or suggests abuse of fiduciary duties by directors and officers; and (f) a discomfort with reliance on monitoring of nonprofit entities by the federal government, particularly by the IRS.

The amount of attention may continue at its current level or increase. In the last several years, a number of steps have been taken by the states' courts and legislatures to enhance the monitoring functions of charitable organizations. For example, as a result of a growing trend of fraud in the solicitation of charitable donations, many states and localities have passed legislation that regulates solicitation by requiring registration of solicitors and filing of reports.[149] Moreover, the federal government recently has increased the likelihood of greater state-federal cooperation with respect to monitoring charitable organizations. Congress enacted an amendment to the I.R.C. § 6104(e) disclosure rules,[150] and added I.R.C. § 4958 intermediate sanction rules.[151] Both may strengthen states' monitoring of charitable

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146. *See id.* I.R.C. § 501(c)(3) organizations accounted for approximately seven percent of gross domestic product in 1990. *See id.*

147. *See* Edward T. Pound et al., *Tax-exempt!*, U.S. NEWS & WORLD REP., Oct. 2, 1995, at 36, 51, *available in* 1995 WL 3114545.

148. *See* AMERICA'S NONPROFIT SECTOR: FACTS AND FIGURES ON THE INDEPENDENT SECTOR 1977-1996 (published pamphlet with fact sheet showing preliminary figures on 1996).

149. *See* Fishman & Schwarz, *supra* note 3, at 260-306; Lyon, *supra* note 3, at 5-37 to -38. The U.S. Supreme Court has limited some of these regulations on charitable solicitations. *See* Village of Schaumburg v. Citizens for a Better Env't, 444 U.S. 620 (1980) (holding unconstitutional an ordinance prohibiting home solicitation by those organizations who were not using seventy-five percent of the receipts for charitable purposes); Riley v. National Fed'n of the Blind, 487 U.S. 781 (1988) (holding unconstitutional a state law requiring licensing and disclosure by organizations who are soliciting). However, state laws regulating solicitation are not uniform, nor is there a model code or standard that applies to interjurisdictional solicitations over the internet.

150. *See supra* note 122.

151. The IRS now has the ability to impose sanctions, via a penalty tax, on disqualified persons and foundation managers of charitable organizations who engage in excess benefit transactions with I.R.C. § 501 (c)(3) and (c)(4) organizations, without being forced to take either extreme position of revocation of the organizations' tax exemption status or sitting idle. *See* I.R.C. § 4958 (1994) (amended 1995).

organizations through the sharing of significant information. Additionally, state attorneys general might be in a position to trust the reformed IRS to a greater extent in the future. As a result of the enactment of the IRS Restructuring and Reform Act of 1998, immediate steps are planned to correct perceived problems that have dishonored the IRS and to instill a greater sense of trust in that agency.[152] Finally, for the moment, the bullish stock market in this country has enhanced the financial well-being of many states, which may in part mean that they will find funds to adequately staff the offices of attorneys general and to support the monitoring of charitable organizations. With these and other such forces as public pressure, there is little, if nothing, to suggest that state and local tax authorities and attorneys general will be quiescent in the near future.

152. *See supra* notes 136-40 and accompanying text.