



LESSENING THE BURDENS OF A CHANGING GOVERNMENT

As governments on all levels outsource many activities, nonprofit entities take up some of the slack.

MARK B. WEINBERG

The watchword of this year's Presidential election was "change." Following the "Reagan Revolution," we are all acutely aware that the public appetite for expensive social programs has abated. Today, federal, state, and local governments outsource many activities they once conducted themselves (including logistical support for wars and, to a much lesser extent, natural disaster relief). One of the most traditional governmental functions, school administration, has been contracted to both for-profit and nonprofit interests. Sometimes the motivation is to distance the government from unpopular programs or reflect lower government outlays. At other times it is to encourage the vaunted creativity of the "private sector." In an era when politicians of both parties laud faith-based initiatives that perform many functions that government has shed, there are some difficult questions that must be answered.

Leaving aside the very important question as to whether outsourcing aspects of government is a good idea at all, if it is done the question remains: How does one balance the interests of the public with those of government? Victims of the Tuskegee Experiment,¹ Japanese-Americans relocated during World War II, and natives of many a Pacific atoll know that what the government decides is for the public good sometimes is not. If administration of those programs had been "privatized," there is

no reason to believe the results would have been less toxic.

Since 1913, Section 501(c)(3) and its predecessors have exempted entities "organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes" from federal income tax if they meet other limitations beyond the scope of this article. At least since 1959, U.S. tax law has characterized "lessening the burdens of government" as being charitable. As governments join with private interests to administer aspects of (or entirely take over) government programs, questions are being raised as to whether this results in the avoidance of rules intended to limit the exercise of government authority, which has implications for the relationship between the government and society. Since status as a charity yields access to government subsidized capital (deductible charitable contributions; exemptions from income, gift, estate, sales, personal property, and real property taxes) and other benefits, the tax savings associated with privatization may be overstated. Properly structured, groups taking on government tasks that are no longer supported by the politicians (because they are too expensive or out of step with current political agendas) can and do utilize these subsidies to lubricate the transition. This article is an inquiry into the meaning of the term "charitable" in this context.

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As the governance of American society has changed, organizations that might not otherwise be charities have successfully claimed that status, with all of its perks, simply through acknowledgement by government that their works lessen the burdens of government. Today, groups as diverse as Guidestar and Free File Alliance, LLC (an affiliate of H&R Block and Intuit) contract with the government to perform functions that would once have been considered governmental in nature. Both are charities recognized by the Service as qualified under Section 501(c)(3), and rightly so. In each case Congress has acknowledged that these groups are undertaking burdens that government would otherwise undertake itself or that is best pursued by a partnership between government and the independent or private sector. Developing case law suggests that what can be lost in transition is a certain amount of accountability, perhaps to the detriment of the same public that the arrangement was designed to serve.

From whence charity springs

The concept of charity is nothing new. The injunction to open one's hand to the poor to win the favor of God appears in Deuteronomy 15:7-11, and the tithe to fund the work of the priests as well as support orphans and widows in Deuteronomy 14:28. The concept of public expenditures being a favored goal of society is evident in the Roman practice of private funding of public spaces and festivals.² A more comprehensive and contemporary definition of charity appears in The Statute of Charitable Uses (1601), which is also referred to as the Statute of Elizabeth (then Queen of England). Interestingly, the Statute of Elizabeth was a reaction by English society to the Anglican Church's split from the Roman Catholic Church (precipitated by Elizabeth's father, Henry VIII), which 'defunded' many of its traditional programs (relief of the poor, for example).³ This secularized previously faith-based programs; how the wheel of history turns.

There has also been a long history of governmental needs being met by entities that were separate and distinct from government and did not, at the time, qualify as charities. Entities that were not part of the federal, state, or local political structure grew up to provide utilities, sell liquor, and maintain public libraries. They were, and are still, called *instrumentalities*,

whether owned or controlled by the federal, state, or local governments.⁴ Regardless of their name or organizational structure, there is a separate inquiry about entities that do things government has done or wishes the new entity to do. Are they charitable? You bet they are.

In 1959, charity was for the first time given a detailed definition in the regulations. Reg. 1.501(c)(3)-1(d)(2) since that time has provided:

The term charitable is used in section 501(c)(3) in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration in section 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of charity as developed by judicial decisions. Such term *includes*: Relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; *lessening of the burdens of Government*; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency. [Emphasis added.]

Applying normal rules of construction to this language, its sweeping breadth becomes apparent.⁵ Charity *includes* (rather than being

¹ "For forty years between 1932 and 1972, the U.S. Public Health Service (PHS) conducted an experiment on 399 black men in the late stages of syphilis. These men, for the most part illiterate sharecroppers from one of the poorest counties in Alabama, were never told what disease they were suffering from or of its seriousness. Informed that they were being treated for 'bad blood,' their doctors had no intention of curing them of syphilis at all.... The data for the experiment was to be collected from autopsies of the men, and they were thus deliberately left to degenerate under the ravages of tertiary syphilis, which can include tumors, heart disease, paralysis, blindness, insanity, and death. 'As I see it,' one of the doctors involved explained, 'we have no further interest in these patients until they die.'" Taken from the Tuskegee Institute Web site, www.tuskegee.edu/Global/Story.asp?s=1207.

² Holland, *Rubicon—The Last Years of the Roman Republic* (Anchor Books, 2003) 273.

³ Persons, Osborn, and Feldman, "Criteria for Exemption Under Section 501(c)(3)," IV Research Papers Sponsored by the Commission on Private Philanthropy and Public Needs (the Filer Commission, 1977), 1909 at 1913.

⁴ These quasi-governmental entities and their enjoyment of either intergovernmental tax immunity or pardon from tax for the conduct of essential governmental functions under Section 115 is a totally separate subject, which readers can discover in a long list of Service documents. The question as to whether wholly owned state or municipal instrumentalities could qualify for 501(c)(3) exemption and associated 403(b) annuity benefits is answered in the affirmative by a long line of service publications from Rev. Rul. 55-319, 1955-1 CB 119, as amplified by Rev. Rul. 60-384, 1960-2 CB 172 through GCM 34553, 7/7/1971 and beyond.

⁵ GCM 33906. ("It is clear, however, that an enlarged concept of charity does appear in the social welfare provisions of the current regulations under section 501(c)(3).")

limited to) several categories of purpose. While *lessening the burdens of government* is deemed charitable, social welfare purposes in four broad classes are also listed.⁶ This suggests that relieving the burdens of government is a separate category in which activities can qualify even if they are neither in the service of the poor, religion, science, education, literature, nor in defense of children or animals or within any of the four social welfare categories.⁷

What is the lessening of the burdens of government?

Historically, the Service has relied on two requirements for any activity to further the charitable purpose of relieving government burdens: (1) the government must have acknowledged the activity as its responsibility and (2) the activity must, in fact, relieve

the burdens government has acknowledged. An activity is a burden of the government if there is an objective manifestation by the governmental unit that it considers the activities of the organization to be its burden. The interrelationship between the governmental unit and the organization may provide evidence that the governmental unit considers the activity to be its burden. Whether the organization is actually lessening the burdens of government is determined by considering all of the relevant facts and circumstances.⁸

The reduction of governmental burdens need not, under published rulings, be the only interests furthered by qualifying activities. In Rev. Rul. 71-29, 1971-1 CB 150 (as interpreted by Rev. Rul. 78-68, 1978-1 CB 149), an organization formed as a Model Cities demonstration project sought to preserve commercial mass transportation in a city while public mass transit was built. The existing commercial company was losing money and an economic study showed that no commercial operation of public transportation in the city would be viable. The organization granted money to the city to underwrite any losses the commercial enterprise incurred during the transition. Rev. Rul. 78-68 tied the program to relief of the burdens of government, but the earlier ruling did not. Instead, Rev. Rul. 71-29 cited general charitable motives of community interest in justifying exemption, even though lessening governmental burdens had been recognized as being charitable since 1959.

Subsequently, in Rev. Rul. 81-276, 1981-2 CB 128, the Service considered the 501(c)(3) status of an organization formed to establish and perform the services of a professional standards review organization under to 42 U.S.C. section 1320c *et. seq.* (1974). The group engaged solely in activities designed to further the purposes of this statute. The Service acknowledged that the group's "activities may indirectly further the interests of the medical profession by promoting public esteem for the medical profession, and by allowing physicians to set their own standards for the review of medicare and medicaid claims and thus prevent outside regulation. However, such benefits to members of the medical profession are incidental to the benefits [it] provides in promoting health and lessening the burdens of government."



CHARITY INCLUDES (RATHER THAN BEING LIMITED TO) SEVERAL CATEGORIES OF PURPOSE.

⁶ The Chief Counsel's file notes indicate these categories were intended to give specificity to the nature of social welfare purposes that could qualify as charitable; the Service acknowledges that their lack of specificity leaves room to extend the principles to whatever limit can be justified under "social and psychological theories." GCM 33906, fn. 2. Yet separation of these four categories from the broader classification "relief of the burdens of government" suggests that activities falling outside these four classes and the more traditional fields of poverty relief, education, etc. can still be charitable so long as they meet a need identified by government.

⁷ Rev. Rul. 74-246, 1974-1 CB 130 (providing reward funds to assist in apprehending criminals relieves the burdens of government). Rev. Rul. 67-325, 1967-2 CB 113, had previously concluded that an organization providing recreational facilities without charge to the residents of a township, but denying access based upon race, was not exempt under Section 501(c)(3). In doing so, however, it observed "... that sections 170, 2055, 2106, and 2522 of the Code, to the extent that they provide deductions for contributions or other transfers to or for the use of organizations organized and operated exclusively for charitable purposes, or to be used for exclusively charitable purposes, do not apply to contributions or transfers to any organization whose purposes are not charitable in the generally accepted legal sense or to any contribution for any purpose that is not charitable in the generally accepted legal sense. For the same reasons, section 501(c)(3) of the Code does not apply to any such organization." This overly broad interpretation was narrowed to appropriate limits in Rev. Rul. 71-447, 1971-2 CB 230, as interpreted by the Supreme Court in *Bob Jones University*, 461 U.S. 574, 52 AFTR2d 83-5001 (1983): "Both the courts and the Internal Revenue Service have long recognized that the statutory requirement of being 'organized and operated exclusively for religious, charitable ... or educational purposes' was intended to express the basic common law concept [of 'charity'].... All charitable trusts, educational or otherwise, are subject to the requirement that the purpose of the trust may not be illegal or contrary to public policy." Rev. Rul. 71-447, *supra* at 230.

⁸ Rev. Rul. 85-2, 1985-1 CB 178 (providing legal advice and training to *guardians ad litem* representing abused or neglected children before a juvenile court met these tests), cited in Rev. Rul. 85-1, 1985-1 CB 177 (providing funds to a county's law enforcement agencies to police illegal narcotic traffic also relieves the burdens of government).

Lessening government burdens— Rallying cry of those who would shrink government

Two recent examples illustrate how charities have stepped into areas where arguably the government should be acting but has failed to do so, demonstrating how important the lessening burdens of government role can be. These examples also illustrate, however, the risks of allocating what should be governmental tasks to private entities.

For many years, it was virtually impossible to get information from charities about their operations, despite the penalties imposed by Sections 6104 and 6652 on their failure to make Forms 990 and determination letters available to the public. Oversight, the *raison d'être* of required public access to those forms, was largely relegated to the news media, which could force compliance by threatening to contact the Service then piece together the information they obtained. Public Internet access to copies of Forms 990 would greatly enhance the ability of the public to know how charities were operating, what they were paying their leaders, and whether they had engaged in improper actions. Should this service be provided by the government, a private for-profit company, or a nonprofit entity?

Some sections of these forms contain confidential information, most notably the lists of contributors that appear on Schedule B. If this information were inadvertently made available by the government to an outside entity, it would be a violation of the privacy provisions of Section 6103. Yet reducing returns to a useable format would be quite expensive and time-consuming. In the end, a nonprofit organization—Philanthropic Research, Inc., a/k/a GuideStar—was chosen to receive tapes from the Service containing electronic data that would permit the recipient to recreate images of the Forms 990 for each nonprofit that filed them. GuideStar then made these images available on its Web site free of charge in connection with data about each organization it had obtained from other sources.

Once the feasibility of this approach was established and many of the kinks had been worked out of the system, GuideStar faced a decision as to whether the incubator of charitable status would be adequate for growing capital needs.⁹ To create capital without entering the capital markets, GuideStar began to ration the availability of the information it had received

from the government (albeit after paying what the charity says is \$1 million in data transcription costs, followed by a \$30,000 patch to preserve tax preparer privacy). While the 990s for the past two or three years were available to the public free of charge, earlier returns, sometimes extending back many years and providing a truer picture of long-term operations, were available only if the user paid \$1,000 per year to purchase this along with other services provided by the charity. After much public grousing, GuideStar agreed to make access to both the Form 990 and the related proprietary information available for a monthly charge of \$100. These decisions were made by GuideStar, not the Service, even though they directly affect public availability of government data.

At least one tax administration and another Internet-related issue of this sort have gone to court with favorable results for the government and its nonprofit collaborators. In *Byers v. Intuit*, 101 AFTR 2d 2008-2441 (DC Pa., 2008) a class action lawsuit was brought against the charitable affiliate of companies that had been awarded the right to serve as the conduits for electronic return filing. In considering preliminary standing and related issues, the court characterized the plaintiffs' allegations as asserting that "[t]he Agreements [between the charity and IRS] wrongfully 'privatized' IRS *e-file* and the IRS's quintessential government task of developing, receiving, collecting and processing tax returns by allowing [the charity's] members to reap profits by charging taxpayers and tax preparers substantial and legally unauthorized fees to electronically file returns with the IRS."

While remanding the case for further action on other issues, the court dismissed the claim that the defendants had violated federal law regarding charges made for government services (the Independent Offices Appropriations Act (IOAA), 31 U.S.C. section 9701). Accord-

⁹ A 1999 article still available on its Web site asks why, at a time when dot-com initial public offerings propelling cyber-pioneers into the economic stratosphere overnight, was GuideStar a nonprofit? "That's becoming an increasingly difficult question to answer," admitted GuideStar CEO Buzz Schmidt. "As our capital needs mount up, it's going to be increasingly difficult to get the kind of responsive capital that we need." Fortunately, the dot.com bust of 2001 did not sweep GuideStar away, perhaps because it was not funded through the capital markets. Recent experience with Freddie Mac and Fannie Mae suggest that failures of government experiments in accessing private capital can be costly/catastrophic. At the time of this writing, estimates for these credit bailouts are now in the billions of dollars.

ing to the court, “electronic tax preparation and filing is a ‘recent and novel’ option, [cite omitted] and though Congress has passed legislation to encourage it, Congress clearly has decided that the IRS need not monopolize it. See H.R. Rep. No. 107-575, p. 38 (2002) (‘[T]he IRS stated that it did not intend to enter into the tax preparation software business; instead, it intended to work in partnership with industry to expand the electronic filing of tax returns.... The Committee strongly believes in the industry-IRS partnership concept....’).”¹⁰

In reaching its decision, the court relied heavily on *Thomas v. Network Solutions, Inc.*, 176 F.3d 500 (CA-D.C., 1999), *aff’g* 2 F.Supp.2d 22 (DC D.C., 1998) which concluded the cooperative agreement between the National Science Foundation and Network Solutions, by which the latter became “the exclusive registry and exclusive registrar for the ‘.com,’ ‘.org,’ ‘.net,’ and ‘.edu’ top-level [Internet] domains,” was not subject to IOAA pricing rules. Under the Court of Appeals’ analysis, the IOAA could apply to fees charged by a private entity only if (1) the private entity were tasked with performing a federal agency’s statutory duty, (2) the federal agency effectively controlled the private entity’s conduct, or (3) the federal agency contracted with the entity to provide a quintessential government service.

Both of these cases denied the application of certain government controls to the provision of services by private parties (a private company in *Thomas*, a charity with close connections to tax preparation groups in *Byers*) that one would have expected a government agency to provide. In these specific cases, claims were made under a statute that was not sufficiently broad to support them. That does not, however, mean that statutes cannot be broadened to ensure accountability among partners of government. Both cases spell out rather clearly that Congress can choose to delegate some of its administrative authority to non-governmental agencies and can sweeten the deal by affording charity status to the groups undertaking these responsibilities. Whether the

entity is a charity or a tax-exempt entity of any type (corporation, LLC, etc.), citizens ought to expect that the groups administering government programs (to which, in some cases, their lives and welfare are entrusted) will be responsive to public demands for efficiency, honesty, and transparency.

As technology, the economy, and the demands of society change, there will be ever greater pressures to keep on-the-books government spending low and harness the profit motives of private enterprise to meet those needs. Recent experience in Iraq and New Orleans suggests that reliance on the profit motive alone to ensure cost-effective (or even proper) conduct of these activities is unwise. Even the Supreme Court last year acknowledged that city government can use its eminent domain authority to condemn private residences for use by a for-profit corporation to expand its facilities.¹¹ Worldwide news coverage of citizens being evicted from their homes to make way for a manicured corporate campus was jarring to say the least.

Charities provide an intermediate step to test cooperative roles before the pursuit of private profit is added to the mix. There are, of course, examples of failures in the nonprofit sector, though these often result from the unbridled greed of specific nonprofit leaders or turf wars among groups providing similar services and competing for scarce dollars. Efforts should be made to select future partners in government cooperation whose leaders have excellent track records for efficiency, integrity, and honesty in the means they use to achieve their missions. This is the least we should expect from those to whom the government entrusts even administrative aspects of its mission.

Conclusion

The government, charitable, and private sectors each have an important role to play in intelligently allocating functions among themselves. In lessening the burdens of government, it is important that the rights of citizens be preserved and protected and accountability be a part of the package deal. ■

¹⁰ *Byers v. Intuit*, 101 AFTR 2d 2008-2441 at 2008-2455 (DC Pa., 2008).

¹¹ *Kelo v. City of New London*, 125 S.Ct. 2655 (2005)