



REID AND RIEGE, P.C.

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CHARITABLE MONEY IS PRIVATE MONEY

In June of this year the Philanthropy Roundtable sponsored publication of a paper entitled *How Public is Private Philanthropy? Separating Reality from Myth*.¹ The paper considers arguments that various interests have been advancing that charitable dollars are “public” or “governmental” dollars – thereby subjecting nonprofit governance and, of course, the distribution of the dollars, to political and public influence at the expense of private interests (donors and governing boards).

The paper deserves the attention of everyone who supports the philanthropic sector regardless of ideology or politics. However, its importance is not derived from its conclusion that charitable money is private money (which is somewhat obvious legally), but from the developments that made the paper necessary in the first place. The paper is necessary because the erosion of the private money principle is an existential threat to the philanthropic sector. It is not our goal to recapitulate the paper (which is available for free on the Web), but to supplement it and to be more hard nosed in defense of the private money principle.

Our starting point is the law of property in general and of charitable property specifically. To “own” property means having enforceable rights to control its use or disposition. These include a right to give other persons an interest in the property. For example: When you mortgage your home you retain ownership but give the bank an interest that can be foreclosed if there is a default. For example: A father can create a trust with separate “controlling” and “beneficial” interests by appointing a bank (the trustee) to control investment and disbursement of funds set aside for the benefit of his children.

When property is donated to a charity several interests are involved: those of the donor (donor intent), the governing board (responsibility for investment and spending), and the beneficiaries (the charitable purpose or class). For example: A donor gives to a homeless shelter – the donor desires to help the homeless, the board invests and uses the money for services, and the homeless are the beneficiaries. For example: A family establishes a private foundation to combat addiction – the family desires to remedy addiction and related problems, the trustees invest and disburse the money for programs and assistance, and the afflicted are the beneficiaries. These two examples illustrate the private money principle: **Charitable funds are funds subject to private control (donors and governing boards) but which are committed in perpetuity to a public purpose or use (and not a private purpose or use).**

When considering the above, two underlying constitutional principles are discernable – private property rights (control of your property), and the freedom of association (to form a nonprofit). The government is not in this picture – other than, and this is important, to afford as a matter of legislative grace (not constitutional right), exemption from taxation. Congress cannot infringe on basic property or association rights – but it could, if it had the votes, adopt legislation creating a world in which contributions aren’t deductible and charities pay income tax – and this fact more than anything else is the source of the argument (if not the confusion) that charitable money is public money. After all – if the government could tax away the dollars, why shouldn’t it be allowed to tell donors and charities how to use them? Before answering this question let’s segue to some examples of the threats to the private money principle.

The Philanthropy Roundtable paper cites the attempts of the Illinois legislature to require the **Illinois Clean Energy Community Foundation** to contribute \$125 million to fund state environmental agencies and general obligation bonds, and of the Republican Governor of Missouri to compel the **Missouri Foundation**

¹ Information about the Philanthropy Roundtable can be found at www.philanthropyroundtable.org. The paper was written by Evelyn Brody, a professor at Chicago-Kent College of Law, and John Tyler, general counsel and secretary of the Ewing Marion Kauffman Foundation.

for Health to use 80% of its grant budget to support underfunded state healthcare agencies. According to online reports the Governor strong armed the foundation's board and noted that because of the benefit of tax-exemption the money rightfully belonged to Missouri taxpayers. Then there are the June 23, 2009 remarks of **Rep. Xavier Becerra (D-Cal)** at a Georgetown University conference – who noted that tax exemption *cost the government* billions each year and questioned whether the dollars the government *forgoes* are spent in the right place (he specified the needs of the people in his district).² In a manifestation of the phenomenon of mothers eating their young, other nonprofits are also getting in on the act – notably the **National Committee for Responsive Philanthropy (NCRP)** and the **Greenlining Institute** – with the NCRP telling foundations how they should spend their money regardless of donor intent and with Greenlining dictating diversity standards to governing boards – especially those of family foundations. NCRP notes that the generous subsidy of tax exemption makes the **government and the public “partners” with philanthropists**. Having forgotten the doctrine of federalism taught in high school civics, **IRS leadership has its nose under the tent** – not only by treading on state law turf by trying to develop its own governance standards,³ but by applying them in a seemingly *ad hoc* and confusing way – such as intimating in a recent ruling that having a board consisting of only family members may by itself be a sufficient reason to deny exemption (family foundations are part of the bedrock of the philanthropic sector).

Let's now segue back to the question – does the fact that the government could tax the dollars away mean that they are public dollars? The answer, of course is no, and the claim that they are is at best a sleight of hand (an attempt to airbrush over well established law with platitudes), and at worst a ruse by people who should know better. When you look at your next paycheck ask yourself if the take home amount is yours to spend as you please (private property) or a governmental subsidy – the net of what the government decides it won't tax away. Does the fact that the government could eliminate the mortgage interest deduction, raise tax rates, or eliminate the charitable contribution deduction (and decrease take home pay) change any of this?

The underlying fallacy of the public dollar argument/deduction is the false premise that in the first instance private dollars are the property of the government – such that it has the right and power to decide what it will “forgo” to “subsidize” private persons and their charitable interests. In fact, under our jurisprudence the money clearly belongs to the people who earned it and the charities to which it is donated, and, as the Philanthropy Roundtable paper suggests, exemption from taxation is a policy deeply imbedded in the social compact of our history and culture. If the government needs money and wants to change the compact it should at least have the courage of its convictions and draft legislation to change the exemption statutes, and then let the political, lobbying and electoral process work to see if public support for the change is there. Better to fight fair than to obfuscate the law by trying to sneak in the back door.

The Reid and Riege Nonprofit Organization Report is a quarterly publication of Reid and Riege, P.C. It is designed to provide nonprofit clients and others with a summary of state and federal legal developments which may be of interest or helpful to them.

This issue of the Nonprofit Organization Report was written by John M. (Jack) Horak, Chair of the Nonprofit Organizations Practice Group at Reid and Riege, P.C., which handles tax, corporate, fiduciary, financial, employment, and regulatory issues for nonprofit organizations. While this report provides readers with information on recent developments which may affect them, they are urged not to act on this report without consultation with their counsel. For information or additional copies of this newsletter, or to be placed on our mailing list, please contact Carrie L. Samperi at 860-240-1008 or info@reidandriege.com, or other members of Reid and Riege, P.C., One Financial Plaza, Hartford, CT 06103. For other information regarding Reid and Riege, P.C., please visit our website at www.reidandriege.com.

² Congressman Becerra is a member of the Committee on Ways and Means, and that Committee has the legal responsibility to raise the revenue required to finance the Federal Government.

³ See the Summer 2008 Edition of this report *The Nonprofit Sector: RIP (the New Form 990 or “SOX” Lite)*, available at www.reidandriege.com.