Taking the Good with the Bad: Recognizing the Negative Externalities Created by Charities and Their Implications for the Charitable Deduction

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The tax code allows taxpayers to deduct amounts donated to an extremely broad variety of organizations deemed to create societal benefits—that is, positive externalities. But many organizations that may receive tax-deductible contributions also cause harms. Both the tax code and subsidy theory, one of the most utilized scholarly theories developed to analyze the deduction from an economic and morally neutral perspective, fail to properly account for these negative externalities. In order to do so, one needs to look beyond the economic models utilized by subsidy theorists. For instance, there should be some limit to the types of harms organizations can cause while retaining their subsidy (that is, their ability to receive deductible contributions), something not adequately provided by the tax laws or the Kaldor–Hicks model used by subsidy theorists. As a starting point, this Article suggests the government should not subsidize organizations that impinge on an individual's ability to live a full and meaningful life as a fair and equal member of society. If this (or some version of this) principle is accepted, taxpayers should not be able to deduct amounts donated to organizations that do so. Additionally, the government should not subsidize the efforts of organizations to promote their views of societal issues upon which there is reasonable disagreement. If one accepts this principle, donors should not be able to deduct amounts given to organizations advancing any particular conception of "the

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good," since allowance of the deduction would result in disparate subsidization of certain competing viewpoints over others, often favoring the majority view. If one applies these suggested principles, it seems clear that the current law's disallowance of deductions made to lobbying organizations and to certain organizations which have race-based exclusion policies is appropriate. However, an application of these same principles would question whether the deduction is appropriate in other situations in which it is currently allowed. For instance, current law allows donors to deduct amounts contributed to certain tax-exempt organizations that engage in limited lobbying; to organizations that are sibling organizations of lobbying groups, which seek to change public opinion through educational efforts; and to groups that have exclusion policies based on criteria other than race. An application of the suggested principles creates questions as to whether this is appropriate. This Article aims to act as a starting point to stimulate further discussion about whether and to what extent donors should be able to deduct amounts donated to charities that not only provide societal benefits but also cause harm.

INTRODUCTION

Since 1917, taxpayers have been entitled to claim charitable deductions[1]—that is, to deduct amounts contributed to "charitable institutions," thereby reducing their taxable income.[2] Despite historical staying power, the underlying policy justification for the charitable deduction is not clear.[3] Indeed,

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1. CHARLES T. CLOTFELTER, FEDERAL TAX POLICY AND CHARITABLE GIVING 11 (1985) (stating that the government enacted the deduction for individual contributions to eligible organizations in 1917); Chauncey Belknap, *The Federal Income Tax Exemption of Charitable Organizations: Its History and Underlying Policy*, *in* COMM'N ON PRIVATE PHILANTHROPY & PUB. NEEDS, 4 RESEARCH PAPERS: TAXES 2025, 2026 (1977) (explaining that the government enacted the charitable deduction in 1917); Charles T. Clotfelter & C. Eugene Steuerle, *Charitable Contributions*, *in* HOW TAXES AFFECT ECONOMIC BEHAVIOR 403, 403 (Henry J. Aaron & Joseph A. Pechman eds., 1981) (same). The deduction enacted in 1917 was limited to 15% of a taxpayer's gross income. Belknap, *supra*, at 2026.

2. Section 170(c) of the U.S. Internal Revenue Code defines the term "charitable contribution" as a "contribution or gift to or for the use of" qualifying organizations. I.R.C. § 170(c) (West 2010). Section 501(c)(3) of the U.S. Internal Revenue Code defines tax-exempt charitable organizations. I.R.C. § 501(c)(3) (West 2010). *See generally* Ellen P. Aprill, *Churches, Politics, and the Charitable Contribution Deduction*, 42 B.C. L. REV. 843, 848–56 (2001) (providing an overview of the history of the charitable contribution deduction); Vada Waters Lindsey, *The Charitable Contributions Deduction: A Historical Review and a Look to the Future*, 81 NEB. L. REV. 1056, 1061–70 (2003) (discussing the legislative history of section 170).

3. *See generally* Mark P. Gergen, *The Case for a Charitable Contributions Deduction*, 74 VA. L. REV. 1393 (1988) (discussing why a charitable contributions deduction should exist and examining various theories that explain the rationale for this deduction); Mark G. Kelman, *Personal Deductions Revisited: Why They Fit Poorly in an "Ideal" Income Tax and Why They Fit Worse in a Far From Ideal World*, 31 STAN. L. REV. 831 (1979) (commenting on Professor William Andrews's analysis of the charitable contribution deduction); Stanley A. Koppelman, *Personal Deductions Under an Ideal Income Tax*, 43 TAX L. REV. 679 (1988) (summarizing scholarship regarding personal deductions).

there is much debate on the subject.[4] Scholars have long toiled with the question of why and under what circumstances taxpayers should be entitled to the deduction, and have developed various theories to answer this question.[5]

In order to properly address this problem, it is important to see what the deduction accomplishes. Assume a taxpayer donates $100 to an organization that entitles her to deduct that amount from her otherwise taxable income. If she is in a 30% tax bracket, the $100 deduction, which reduces her income by that same amount, has a value of $30, meaning her $100 donation only costs her $70 after-tax.

From this simple example, one can see that the charitable deduction provides an incentive to taxpayers to make donations to institutions that enable them to claim the deduction. Because the deduction lowers the after-tax cost of the donation, taxpayers will donate more than they would have otherwise donated.[6]

Further, one can see that by granting this deduction the government provides a subsidy to the organization to which the donated money has been paid. In the example provided, the taxpayer received a $30 deduction—thus, the taxpayer paid $70 to the organization of her choosing and the government subsidized the remaining $30. The charitable deduction is economically equivalent to the government providing a direct payment to the organization that the taxpayer selected,[7] and the government should, therefore, not grant charitable deductions in cases where direct subsidies would be deemed inappropriate.[8]

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4.   *See* John D. Colombo, *The Marketing of Philanthropy and the Charitable Contributions Deduction: Integrating Theories for the Deduction and Tax Exemption*, 36 WAKE FOREST L. REV. 657, 659 (2001) ("Academic interest in the topic has been equally significant. Much has been written over the past three decades about the section 170 deduction.").

5.   Various scholars have examined the even more general question of when the government should grant taxpayers deductions for expenditures that are personal in nature, as opposed to those associated with a business or profit-making activity, and they have applied relevant concepts to the specific question of when a charitable deduction should be granted. *See generally* William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309 (1979) (discussing an ideal personal income tax, the medical expense deduction, the charitable contribution deduction, and the implications of this analysis for other aspects of personal income taxation); Kelman, *supra* note 3 (commenting on Professor Andrews's analysis of personal deductions and the charitable deduction).

6.   Indeed, legislative history suggests that the creation of this incentive was the explicit point of enacting the deduction. *See infra* notes 22–23 and accompanying text.

7.   *See* Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705, 706 (1970). The deduction is just one of many ways in which the government can provide financial assistance to organizations. Rather than incentivizing certain behaviors through a deduction, the government could provide a direct expenditure, such as a direct grant or a subsidy. There are indeed many other types of direct expenditure programs, such as "loans, interest subsidies, guarantees of loan repayment or interest payments, [and] insurance on investments." *Id.* at 713. For any provided tax incentive, one could construct a direct expenditure program with the same economic effect. For instance, rather than providing taxpayers a deduction from taxable income for amounts donated to charity, the government could match such amounts by giving grants equal to a proportionate amount of

With these concepts in mind, one can turn to the essential question: what sorts of organizations should the government subsidize by allowing taxpayers to deduct amounts donated to them?

Currently, taxpayers may deduct amounts donated to organizations that meet the requirements set forth in section 170(c).[9] In order to qualify under this section, the organization must have one of the listed purposes deemed to create societal benefits. These purposes are broad, leading to a rapid proliferation of organizations to which taxpayers may make deductible contributions.[10] Further,

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the donation. *See id.* at 714 ("The existing tax incentive for charitable giving could also be structured as a direct expenditure program, under which the Government would match an individual's contribution to charity with a proportional contribution of its own to the same charity."). Assume that Taxpayer A is in a 30% tax bracket, and donates $100 to an organization in a manner that qualifies for the charitable deduction. Taxpayer A claims a deduction worth $30. Under a direct expenditure program, the government could instead offer to pay $30 for every $70 donation, thereby achieving the same effect.

8.   Once one properly views the charitable deduction as one version of an organizational subsidy, it is clear that tax deductions should meet the same criteria as direct expenditures and should be limited in a similar manner. *See id.* at 726 ("[W]hatever degree of scrutiny and care should be applied to direct expenditures should also be applied to tax incentives [such as the charitable deduction]."). Professor Surrey defines tax expenditures or tax incentives as follows: unless the charitable deduction is a necessary adjustment to the income tax base it constitutes a "tax expenditure." *Id.* at 724. Professor Surrey explains this term as follows:

> The term "tax expenditure" has been used to describe those special provisions of the federal income tax system which represent government expenditures made through that system to achieve various social and economic objectives. These special provisions provide deductions, credits, exclusions, exemptions, deferrals, and preferential rates, and serve ends similar in nature to those served by direct government expenditures or loan programs.

Id. at 706.

    Professor Surrey further states:

> A government that decides it is wise to pay out tax credit money via a simple tax schedule would be highly irrational if it also decided that it would be unwise to pay the same amount directly on the same basis. A dollar is a dollar—both for the person who receives it and the government that pays it, whether the dollar comes with a tax credit label or a direct expenditure label.

Id. at 717.

9.   I.R.C. § 170(c) (West 2010); *see also* Treas. Reg. § 1.501(c)(3)-1(d)(2) (as amended in 2008).

10.   The number of tax-exempt organizations to which taxpayers may make deductible contributions is rapidly increasing. A recent article reported that "[t]he number of organizations that can offer their donors a tax break in the name of charity has grown more than 60 percent in the United States, to 1.1 million," in the last decade. Stephanie Strom, *Charities Rise, Costing U.S. Billions in Tax Breaks*, N.Y. TIMES, Dec. 6, 2009, at A1. It was estimated that "[t]he $300 billion donated to charities last year cost the federal government more than $50 billion in lost tax revenue." *Id.* Further, with nothing more concrete than the language in section 501(c)(3), there is no principled way under current law for the IRS to curb this trend. A recent study showed that the IRS approved more than 98% of applications filed by organizations seeking tax-exempt status. ROB REICH ET AL., STANFORD UNIV. CTR.

these requirements fail to account for the fact that charities, while performing designated functions deemed to create positive societal benefits (positive externalities), may also cause harm (negative externalities). More rational limitations are therefore needed.

Subsidy theory is one of the most utilized theories offered to analyze the charitable deduction from an economic, morally neutral perspective and to provide further limitations on the deduction. While a useful starting point for analyzing the deduction, this Article will show that even this theory fails to properly account for important situations in which charities cause negative externalities, suggesting that additional factors must be developed.

Part I discusses the basic framework developed by subsidy theorists to determine when a deduction for personal expenditures, such as the charitable deduction, is justified.[11] The theory posits that a deduction for charitable expenditures is needed to encourage giving that would not occur in its absence. According to subsidy theory, a deduction should not be granted unless three conditions are met: (1) the donation is given to an organization that produces a public good; (2) the public good would be underfunded in the absence of the deduction; and (3) the transfer from the donor-taxpayer to the donee-organization is efficient.[12] After presenting the general notions behind each of subsidy theory's three criteria, Part II will focus on the efficiency prong. An analysis of the underfunding prong will be reserved for a future article.

In considering the efficiency prong, subsidy theorists generally discuss two common models of efficiency: the Pareto model and the Kaldor–Hicks model. A transfer is said to be Pareto efficient if the transfer would "make at least one person better off and no one worse off."[13] This seems to provide an ideal measure for determining whether a charitable deduction is warranted as it ensures that taxpayers will not be harmed by governmentally provided funds. It will, however, always be the case that some parties will be harmed to some extent when a tax-deductible donation is made. At the very least, because the cost of the deduction will be spread among all taxpayers, some segment of society will always suffer what this Article calls "universal subsidization harm." As a result of the inevitability of some harm, disallowing deductions for all transfers that are not Pareto efficient would eviscerate the deduction.

Subsidy theorists, therefore, use the Kaldor–Hicks model as an alternative measure that would prevent this result but still allow efficiency to be considered. A transfer will be deemed Kaldor–Hicks efficient if the net benefits of the donation exceed the resulting harms. Thus, roughly, one would identify the group benefitted

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ON PHILANTHROPY AND CIVIL SOC'Y, ANYTHING GOES: APPROVAL OF NONPROFIT STATUS BY THE IRS 9 (2009), *available at* http://www.stanford.edu/~sdsachs/ AnythingGoesPACS1109.pdf.

    11.   *See infra* Part I.A.
    12.   In this way, the deduction will enable political minorities to overcome collective action problems to better fund public goods that might be underfunded if support depended on the political sphere. Gergen, *supra* note 3, at 1399.
    13.   ANTHONY BARNES ATKINSON & JOSEPH E. STIGLITZ, LECTURES ON PUBLIC ECONOMICS 337 (1980); *see also* Gergen, *supra* note 3, at 1401.

by the donations and the group harmed by the donations, and so long as the former group benefitted more than the latter group was harmed, the transfer would be deemed efficient and a deduction would be warranted under the efficiency prong.

Scholarship has not directly considered whether the efficiency criteria, once applied, can sensibly separate transfers that should and should not receive a charitable deduction. While the Kaldor–Hicks model provides a useful starting point for analyzing the charitable deduction, this Article argues that the model does not always yield results that are appropriate in assessing whether a charitable deduction should be allowed for a particular transfer. Subsidy theorists make certain assumptions about the nature of the harm suffered by the harmed group. Specifically, they assume the harm of subsidizing a charity is limited to the universal subsidization harm and the psychic harm one suffers from living in a world in which others may deduct amounts donated to organizations one views as foolish or strange.[14] In economic terms, the harmed group is assumed to be relatively indifferent.[15]

Like the tax code, this fails to recognize that charities, in addition to supposedly creating positive externalities, may also create rather profound negative externalities. In light of this, even scholars of subsidy theory have failed to focus on how to analyze the case for a charitable deduction when the donee-organization has caused harms beyond those assumed.

To illustrate this gap, Part II starts with the case assumed by subsidy-theory scholars where the group harmed by a donation is confined to relatively indifferent parties—that is, harm is confined to slight psychic harms and universal subsidization harm. As shown, it will generally be rather easy for these transfers to meet the efficiency prong of the subsidy analysis, and it seems appropriate to allow charitable deductions in these cases, as long as the other prongs of the theory are satisfied.

Part II then relaxes these assumptions and presents several cases where the harm caused by donee-organizations is not limited in the assumed manner. These cases show that the Kaldor–Hicks model is not sufficient to determine whether taxpayers should receive a charitable deduction for amounts donated to these organizations. Having exposed this gap, this Article provides preliminary suggestions as to how it might be filled.

First, there should be some limit to the types of harm that the government should subsidize. The Kaldor–Hicks model does not adequately provide this limit. As a starting point, this Article suggests that the government should not subsidize behavior that impinges on any individual's ability to live a full and meaningful life[16] as a free and equal member of society.[17] If this principle is accepted, the law

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14. *See* Gergen, *supra* note 3, at 1400–06, 1412.
15. *See generally id.*
16. Political philosopher John Rawls states that a person should be able to "take part in, or . . . play a role in, social life, and hence exercise and respect its various rights and duties. Thus, we say that a person is someone who can be a citizen, that is, a normal and fully cooperating member of society over a complete life." JOHN RAWLS, POLITICAL LIBERALISM 18 (expanded ed. 2005). This (and the second preliminary principle described below) is derived from Rawls's notions of a well-ordered democratic society. *Id.* This

should not allow donors to deduct amounts donated to organizations that cause such harm, even if the economic models would suggest that these transfers are efficient.[18]

Second, when there is a reasonable disagreement among the population as to what is desirable, the government should not subsidize any one conception. Thus, deductions should not be granted for amounts contributed to organizations that advocate one particular conception of "the good."[19] Allowing the deduction would always result in disparate subsidization of some positions over others, often favoring the position advocated by groups with the largest support bases.

Current law complies with these principles only to a limited extent. For instance, current law does not allow taxpayers to deduct amounts contributed to educational and certain other organizations that have exclusion policies based on race. This is in accord with the first principle because hindering one's ability to participate in activities based on the color of one's skin impinges on a person's ability to participate as a fair and equal member of society. However, the law currently allows taxpayers to deduct amounts contributed to organizations with exclusion policies based on criteria other than race, such as sexual orientation. This violates the first principle, suggesting a deduction is inappropriate.

Further, the law currently disallows deductions for transfers to lobbying organizations that strive to influence legislation. This accords with the second suggested principle that the government should not subsidize any particular conception of "the good" when there is a reasonable disagreement. However, under current law, taxpayers may deduct donations to certain 501(c)(3) organizations engaged in limited lobbying and to organizations that seek to change public opinion about debated societal issues through educational efforts, as long as there is no direct attempt to influence legislation. This runs afoul of the second proposed principle, which suggests that allowing taxpayers to deduct amounts donated to these organizations is inappropriate.

Article's usage of theses principles is by no means intended to make a philosophical judgment as to whether these notions are appropriate as overall societal goals. The principles were selected because they seem to provide a sensible "floor" for limiting the harms that the government might subsidize and were particularly appropriate for analyzing the types of negative externalities discussed in this Article. These principles are used for the narrow purpose of showing that, if the principles are accepted, certain organizations currently able to receive deductible contributions should receive further scrutiny. More appropriate articulations of these ideas may emerge in future discussions.

17.   A citizen is a "free and equal" person. *Id.* at 19.

18.   Rawls believes that when there is a "plurality of reasonable doctrines"—that is, when there are various non-reconcilable conceptions of "the good" all of which could be believed by reasonable people—then "it is unreasonable or worse to want to use the sanctions of state power to correct, or to punish those who disagree with us." *Id.* at 138.

19.   *Id.*

I. THE BASIC FRAMEWORK PROVIDED BY SUBSIDY THEORY: A STARTING POINT

A popular justification for the charitable deduction is that it provides an "incentive by which the tax law encourages desirable behavior."[20] Granting a deduction for a particular donative action likely increases the reoccurrence of that action because, all else equal, the cost to the taxpayer is reduced.[21] Legislative history supports this construction. The government enacted the charitable deduction as part of the Second Revenue Act of 1917, which dramatically increased tax rates from 7% to 51% in order to fund the United States' efforts in World War I.[22] Senator Hollis stated:

> It will work in this way: Usually people contribute to charities and educational objects out of their surplus. After they have done everything else they want to do, after they have educated their children and traveled and spent their money on everything they really want or think they want, then, if they have something left over, they will contribute it to a college or to the Red Cross or for some scientific purposes. Now, when war comes and we impose these very heavy taxes on incomes, that will be the first place where the wealthy men will be tempted to economize, namely, in donations to charity. They will say, "Charity begins at home."[23]

Concerned that the increased tax burden would diminish people's willingness (and perhaps ability) to make charitable donations, the deduction was granted. Thus, legislative history explicitly indicates that the government enacted the deduction because of its hoped incentive effects.

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20.   CLOTFELTER, *supra* note 1, at 280; *see also* RICHARD GOODE, THE INDIVIDUAL INCOME TAX 161 (rev. ed. 1976) (stating that the primary justification for the philanthropic contributions deduction is "encouragement or reward of socially desirable activity"); C. HARRY KAHN, PERSONAL DEDUCTIONS IN THE FEDERAL INCOME TAX 13 (1960) (noting that one of three reasons for personal deductions is the desire to provide an incentive for certain expenditures and that the charitable deduction is usually justified on that ground); Colombo, *supra* note 4, at 661 (stating that "existing literature surrounding the section 170 deduction generally accepts the subsidization role of the deduction"); C. Eugene Steuerle & Martin A. Sullivan, *Toward More Simple and Effective Giving: Reforming the Tax Rules for Charitable Contributions and Charitable Organizations*, 12 AM. J. TAX POL'Y 399, 403 (1995) (explaining that one of the two principal justifications for the charitable deduction is that it provides a tax incentive for taxpayers to contribute to appropriate causes).

21.   *See* Aprill, *supra* note 2, at 856 ("The assumption is that, because the permitted deduction lowers the price of contribution, taxpayers will give more when the price is lower.").

22.   *See* John A. Wallace & Robert W. Fisher, *The Charitable Deduction Under Section 170 of the Internal Revenue Code, in* COMM'N ON PRIVATE PHILANTHROPY & PUB. NEEDS, 4 RESEARCH PAPERS: TAXES 2131–61 (1977); *see also* KAHN, *supra* note 20, at 46–48 (discussing the legislative background of philanthropic contributions); Aprill, *supra* note 2, at 848–56 (providing an overview of the history of the charitable contribution deduction); Lindsey, *supra* note 2, at 1061–70 (same).

23.   55 CONG. REC. 6728 (1917) (statement of Senator Henry Hollis).

It is essential to recognize the effects of this incentive mechanism. By allowing taxpayers to deduct amounts given to organizations to which they have chosen to donate, the government provides a subsidy to those organizations.[24] The charitable deduction is a unique method of providing the subsidy since it is the taxpayer's action that triggers it, and it is the taxpayer who decides which organizations to subsidize.[25] Thus, there must be compelling reasons for allocating public funds in this manner rather than having Congress allocate funds, as is ordinarily done. The idea generally accepted by scholars has been explained in various ways, but the basic tenet is that the deduction is essential to protect minority interests.[26] If Congress had the ability to implement the subsidies, only those goods preferred by a majority of voters would be provided.[27] Scholars allege that a tax deduction, as compared to a direct assistance plan (that is, a plan where Congress selects which organizations to subsidize), is a better method to fund charities because of its superior ability to prevent a so-called tyranny of the majority and to promote pluralism.[28] Under this reasoning, the deduction allows taxpayers to choose the organizations to which they will donate, so even organizations with small support bases are able to receive aid.[29] A direct assistance program, it is argued, would be poorly suited to preserve these goals.[30] Scholars fear that the list of funded organizations, as revised by politicians, would begin to resemble the wish lists of large constituencies, leaving out smaller organizations whose supporters cannot reward politicians with numerous votes.[31] In contrast, deductions let each taxpayer vote with his or her own dollars,[32] allowing for the formation of new groups that can fund minority projects.[33]

With these goals in mind, the question is: what sorts of organizations should the government subsidize by allowing taxpayers to deduct amounts donated to them?

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24.   *See generally* Surrey, *supra* note 7.
25.   *See, e.g.*, Boris I. Bittker, *Charitable Contributions: Tax Deductions or Matching Grants?*, 28 TAX L. REV. 37, 45 (1972); Saul Levmore, *Taxes as Ballots*, 65 U. CHI. L. REV. 387, 405 (1998). *See generally* Miranda Perry Fleischer, *Generous to a Fault? Fair Shares and Charitable Giving*, 93 MINN. L. REV. 165 (2008).
26.   *See, e.g.*, Bittker, *supra* note 25, at 46.
27.   *See id.* at 45–46.
28.   *See* Peter J. Wiedenbeck, *Charitable Contributions: A Policy Perspective*, 50 MO. L. REV. 85, 96 (1985) ("[T]he charitable contribution deduction encourages cultural and associational pluralism."); *see also* Burton A. Weisbrod, *Toward a Theory of the Voluntary Nonprofit Sector in a Three-Sector Economy*, *in* THE ECONOMICS OF NONPROFIT INSTITUTIONS 21, 23–25, 36–37 (Susan Rose-Ackerman ed., 1986) (using an economic model to suggest that government provision of nonprofit services will align with interests of the majority of voters).
29.   Wiedenbeck, *supra* note 28, at 97.
30.   *See* Bittker, *supra* note 25, at 46 ("I must say that I have very little confidence that a system of matching grants could be administered without administrative and congressional investigations, loyalty oaths, informal or implicit warnings against heterodoxy and the other trappings of governmental support that the tax deduction has, so far, been able to escape.").
31.   *Id.*
32.   Levmore, *supra* note 25.
33.   Fleischer, *supra* note 25, at 207–10.

Currently, taxpayers may deduct amounts donated to organizations that meet the criteria set forth in section 170(c).[34] These organizations include those that are "organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition . . . or for the prevention of cruelty to children or animals."[35] This mirrors the language of section 501(c)(3), which provides that entities organized and operated in this manner will not be subject to income taxation so long as they meet the other requirements of that section.[36]

This definition is extremely broad and has led to the rapid proliferation of organizations to which donors may make tax-deductible contributions.[37] Importantly, it fails to account in any way for the harms that charities might cause. In light of this, more rational limitations on the types of organizations to which donors may make deductible contributions are needed.

Subsidy theory is one of the most utilized theories to provide these additional limits by offering an economic, morally neutral model for analyzing the deduction. Scholars of subsidy theory maintain that the government should provide a deduction for donated amounts only when needed to encourage desirable giving that would not occur in its absence.[38] Subsidy theorists deem this goal fulfilled, and a deduction justified, if three conditions are met.[39] First, the organization to which the donation is made must provide a public good.[40] Second, the public good must be one that would be underfunded or sub-optimally provided in the absence of a deduction.[41] Third, the transfer from donor-taxpayer to donee-organization must be efficiency enhancing from an overall societal perspective.[42] When these criteria are met, subsidy theorists argue that the deduction will allow political minorities to surmount free-rider problems in order to optimally fund goods that

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34.   I.R.C. § 170(c) (West 2010).
35.   *Id.* § 170(c)(2)(B).
36.   *Id.* § 501(c)(3). The regulations explicate the meaning of charitable as follows:

> The term charitable is used . . . in its generally accepted legal sense . . . .
> [It] includes: [r]elief 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 the
> burdens of [g]overnment; . . . lessen[ing] neighborhood tensions; . . .
> eliminat[ing] prejudice and discrimination; . . . defend[ing] human and
> civil rights secured by law; [and] combat[ing] community deterioration
> and juvenile delinquency.

Treas. Reg. § 1.501(c)(3)-1(d)(2) (as amended in 2008).
37.   *See supra* note 10 and accompanying text.
38.   *See generally* Johnny Rex Buckles, *The Case for the Taxpaying Good Samaritan: Deducting Earmarked Transfers to Charity Under Federal Income Tax Law, Theory and Policy*, 70 FORDHAM L. REV. 1243, 1285–88 (2002) (explaining subsidy theory through observations of its proponents); Gergen, *supra* note 3, at 1396–1414 (discussing basic concepts of subsidy theory and refinements); Lindsey, *supra* note 2 (same).
39.   *See* Gergen, *supra* note 3, at 1396–1406.
40.   *See id.*
41.   *See id.*
42.   *See id.*

would otherwise be sub-optimally provided.[43] This, therefore, accords with the minority-protecting and pluralistic goals at the heart of the deduction's justification.

Before further explaining these criteria, it is important to note how this discussion relates to so-called tax-base theories, another line of thought regarding personal deductions, such as the charitable deduction. Subsidy theory seeks to answer the following question: under what circumstances can the government justify giving federal money in the form of a tax deduction for expenditures that would otherwise be part of the tax base? Put another way, subsidy theory seeks to determine when the government ought to grant deductions for taxpayer expenditures (for example, charitable giving). One can use subsidy theory only after one has concluded or assumed that the deduction is not a needed adjustment to taxpayer income that is necessary to properly calculate the income tax base, however defined.[44]

For instance, subsidy theory is an inappropriate model to analyze whether the law should permit taxpayers to deduct business expenses from gross income because the current tax system seeks to tax net (as opposed to gross) profits.[45] Deduction of business expenditures is, therefore, a necessary adjustment to the income tax base, as currently defined, making the subsidy theory unneeded.

It is not always so easy to determine what constitutes a necessary adjustment to the tax base. Indeed, the law does not define other aspects of the tax base as clearly as in the above example, making the inquiry more complicated. For instance, knowing that the tax base is meant to tax net rather than gross profits does not help answer whether a deduction for donations made to charitable organizations (however defined) constitutes a necessary adjustment to taxpayer income. This requires closer analysis of what constitutes the current tax base, a definitional inquiry that proves difficult.

Notable scholars have toiled with this question, seeking to provide a comprehensive definition of "income" for purposes of determining the proper

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43. *Id.* at 1397–1400.

44. *See, e.g.*, Andrews, *supra* note 5, at 311–12. Professor Andrews discusses the way in which subsidy theory and tax-base theories interrelate. He explains that before concluding a deduction is equivalent to a direct expenditure such that subsidy theory should apply, it is:

> imperative to consider carefully whether a provision can be defended by reference to intrinsic matters of tax policy before evaluating it as if it were something else. The tax expenditure analysis itself does not lead us to focus on that question because characterization as a tax expenditure and analogy to a direct expenditure generally imply that the provision serves purposes outside those of the tax system.

Id. at 312; *see also* Surrey, *supra* note 7, at 706 (explaining that classifying expenditures as equivalent to direct expenditures "involves a major definitional question: which tax rules are special provisions and therefore tax expenditures, and which tax rules are just tax rules[,] simply part of the warp and woof of a tax structure?").

45. *See* I.R.C. § 162(a) (West 2010).

income tax base.[46] Such scholars, developing and focusing on tax-base theories, evaluate the appropriateness of personal deductions, such as those for charitable giving, by asking whether it is an appropriate exclusion from the tax base—if it embodies "the intrinsic objectives of the [income] tax."[47] In doing so, scholars disagree on the proper definition of income to be used in calculating the income tax base.[48] Further, even when scholars agree upon a definition, they disagree as to whether and to what extent personal expenditures such as charitable donations necessitate a deduction, often resulting in intense interchanges.[49]

This Article does not endeavor to reconcile these difficult issues.[50] However, it is important to recognize the implications of tax-base theories as they relate to subsidy theory and the Article's analysis. If a charitable deduction is needed to properly calculate the tax base, subsidy theory's analysis would become immaterial.[51] Thus, to the extent a particular deduction is unwarranted under subsidy analysis, it may still potentially be warranted under one or several tax-base theories.

Despite this, an inquiry into subsidy theory remains essential, especially when one considers the ongoing nature of the disagreements associated with tax-base theories. If the caliber of scholars who have, to date, failed to come to an agreement serves as an indication, then the discussion of what constitutes a proper

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46.   *See, e.g.*, GOODE, *supra* note 20, at 13–17 (analyzing the definition of income in the context of income as a tax base); Andrews, *supra* note 5, at 318–25 (discussing the meaning of personal income); Johnny Rex Buckles, *The Community Income Theory of the Charitable Contributions Deduction*, 80 IND. L.J. 947, 953 (2005) (noting that "a proper conception of 'income' is of utmost importance to the debate on the legitimacy of the charitable contributions deduction"). *See generally* Koppelman, *supra* note 3 (summarizing various tax-base theories).

47.   Andrews, *supra* note 5, at 312.

48.   *See, e.g.*, Buckles, *supra* note 46, at 954–61 (discussing the uncertain meaning of income); Koppelman, *supra* note 3, at 687 ("The uncertain role of personal deductions reflects an underlying uncertainty about the meaning of income as a base for personal taxation. Indeed, the divergent views on personal deductions may be traced to differing perspectives on the meaning of income.").

49.   For such an interchange, see Andrews, *supra* note 5, at 309–17, in which Andrews provides a formulation of income and argues this formulation requires that charitable donations be deductible. Then, for vigorous commentary disagreeing with Professor Andrews's formulation, see, for example, Kelman, *supra* note 3, at 838, and Koppelman, *supra* note 3, at 687–705. *See also* Buckles, *supra* note 46, at 958 ("Not all students of Henry Simons embrace the justification for the charitable contributions deduction advanced by Professor Andrews. Chief among Andrews's critics are Professors Mark Kelman and Stanley Koppelman.").

50.   For an excellent discussion of various tax-base theories, see Koppelman, *supra* note 3, at 967–75. *See generally* Buckles, *supra* note 46 (focusing on tax-base theories in support of the charitable contributions deduction).

51.   CLOTFELTER, *supra* note 1, at 280 ("If the deduction is seen as an absolutely necessary adjustment to income, it becomes 'a matter of principle,' and there remains little to discuss concerning the proper tax treatment of charitable giving." (quoting George F. Break, *Charitable Contributions Under the Federal Individual Income Tax: Alternative Policy Options*, *in* COMM'N ON PRIVATE PHILANTHROPY & PUB. NEEDS, 3 RESEARCH PAPERS: SPECIAL BEHAVIORAL STUDIES, FOUNDATIONS, AND CORPORATIONS 1521, 1530 (1977))).

definition of income, and whether the charitable deduction can be justified under any chosen definition, is unlikely to be soon resolved. As a result, it is useful to inquire how subsidy theory fares if one assumes the charitable deduction is not a necessary adjustment to the tax base. The remainder of this Article makes this assumption.

This Part will now discuss the three prongs of subsidy theory's analysis— namely, that a deduction is justified if the organization to which the donation is made provides a public good, if the public good would be underfunded or sub-optimally provided in the absence of a deduction, and if the transfer from the donor-taxpayer to the donee-organization is efficiency enhancing from an overall societal perspective.[52]

A. (Quasi-) Public or Collective Goods

Scholars of subsidy theory assert that taxpayers should receive a charitable deduction only for amounts given to organizations that provide public goods.[53] As an economic concept, a public good, also known and referred to interchangeably as a collective good, refers to a good with the properties of "non-rivalrous consumption" and "non-excludability."[54] Non-rivalrous consumption describes a good that is in "joint supply, [such that] one person's consumption of it does not reduce the amount available to anyone else."[55] Non-excludability means that individuals cannot practically be prevented from consuming the good.[56] A

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52. Gergen, *supra* note 3, at 1396–1406.

53. *See* Andrews, *supra* note 5, at 357 (explaining that the basis for arguments in favor of the deduction is the fact that most charitable organizations produce "something in the nature of common or social goods or services"); Andrew Chamberlain & Mark Sussman, *Charities and Public Goods: The Case for Reforming the Federal Income Tax Deduction for Charitable Gifts*, TAX FOUND. SPECIAL REP. NO. 137, at 3 (Nov. 2005) (arguing that the economic justification for the tax subsidy to charities requires qualified charities to produce public goods); Gergen, *supra* note 3, at 1397–98 (stating that "[t]he starting point of the subsidy theory is the observation that charities provide public goods which we wish to have provided without charge to their beneficiaries"); *see also* HERBERT KIESLING, TAXATION AND PUBLIC GOODS 201–02 (1934).

54. Chamberlain & Sussman, *supra* note 53, at 2; *see also* KIESLING, *supra* note 53, at 9–12 (providing a comprehensive definition of public goods and emphasizing the demand characteristic and the fact of common supply).

55. *See* RUSSELL HARDIN, COLLECTIVE ACTION 17 (1982); *see also* Chamberlain & Sussman, *supra* note 53, at 2 (stating that "non-rivalrous consumption," in plain language, means one individual's use does not reduce the amount of the good left for others); Gergen, *supra* note 3, at 1397 (explaining that when one individual's consumption of a public good does not reduce its availability to other individuals, then the good is "nonrival or in joint supply").

56. *See* HARDIN, *supra* note 55, at 17 ("It is impossible to prevent relevant people from consuming [a pure public good]."); Chamberlain & Sussman, *supra* note 53, at 2 (defining "non-excludability" as meaning that people who do not pay to consume the good cannot be prevented from using the good); Gergen, *supra* note 3, at 1397 (explaining that if no one can exclude another from a good, then it is non-exclusive).

lighthouse, for example, is a quintessential public good.[57] One's supply of usable light is in no way affected by others' use, and thus a lighthouse possesses the property of non-rivalrous consumption.[58] A lighthouse also illustrates non-excludability because no one can reasonably prevent another individual in its sightline from viewing its light.[59]

Pure public goods that are truly non-rivalrous and non-excludable are rare.[60] Even air supply fails to fall squarely within the definition: "if enough people consume it in various ways, what is left for others to use is greatly altered."[61] Thus, in determining to what types of organizations the law should encourage taxpayer contributions, the focus must turn to provision of quasi-public goods—that is, to organizations providing goods that are "similar to public goods over some range."[62]

It is beyond the scope of this Article to define whether a particular good is "public enough" to allow organizations providing it to receive deductible contributions. Indeed, many, if not most, organizations that are currently able to receive deductible contributions provide goods that may not meet the definition of a pure public good.[63] Consider an organization that provides medical research: the additional knowledge accumulated through research seems non-rival because application of that knowledge—to a particular patient, for example—does not seem to preclude its application by or for others.[64] It is less clear whether the non-excludability requirement would be fulfilled, as patents or licensing arrangements may exclude individuals from using the medical advancements produced by conducted research.[65] Thus, although taxpayers may deduct amounts donated to

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57.   *See generally* R. H. Coase, *The Lighthouse in Economics*, 17 J.L. & ECON. 357 (1974) (discussing the lighthouse example in the context of economics and public goods).

58.   *Id.* at 359.

59.   *Id.*

60.   "[W]e are left with the problem of reconciling ourselves to a neat definition of collective goods that is apparently inapplicable to nearly all the familiar instances of collective goods." HARDIN, *supra* note 55, at 18–19 (quoting E.T. Mishan, *The Relationship Between Joint Products, Collective Goods, and External Effects*, 77 J. POL. ECON. 329, 334 (1969)); *see also* Robert W. Adler, *Unfunded Mandates and Fiscal Federalism: A Critique*, 50 VAND. L. REV. 1137, 1249 (1997) (stating that "'pure' public goods that benefit all national taxpayers equally . . . are extremely rare"); John D. Colombo, *Why is Harvard Tax-Exempt? (And Other Mysteries of Tax Exemption for Private Educational Institutions)*, 35 ARIZ. L. REV. 841, 869 (1993) (explaining that pure public goods are rare, and most goods and services are imperfect hybrids).

61.   HARDIN, *supra* note 55, at 17.

62.   *Id.* at 19.

63.   *See* Gergen, *supra* note 3, at 1397–99 (questioning the premise that goods provided by certain tax exempt organization are truly public goods).

64.   *See supra* note 55 and accompanying text.

65.   *See* Chamberlain & Sussman, *supra* note 53, at 4 ("Neither hospitals nor universities can plausibly be said to fit the economist's definition of public goods. Their primary services are direct hospital care to patients, and research and direct classroom instruction to students. Those who refuse to pay can easily be excluded from both, and one

such organizations under current law, it is not clear that the goods provided by medical research organizations meet the economic definition of a pure public good.[66]

Current law also allows taxpayers to deduct amounts contributed to opera halls and houses of worship.[67] The goods produced by opera halls and houses of worship suffer from the opposite defect. Even if these venues are open to all interested, thereby eliminating exclusivity problems, the provision of opera performances and religious services possess an element of rivalry when the physical space provided for the performance or service reaches maximum capacity.[68]

While few organizations will actually provide pure public goods, it is clear that donors should only be able to deduct amounts given to organizations that provide goods which are different in character from purely non-public goods.[69] For example, a taxpayer should not receive a deduction for amounts spent to purchase a meal for himself, as it is both rivalrous (once eaten, others cannot) and excludable (the taxpayer can easily prevent others from consuming his meal), falling clearly outside the definition of a public good.[70] On the other hand, while one probably thinks that a taxpayer should receive a deduction for amounts donated to feeding the poor, the food provided will still not meet the pure definition of a public good—once one person receives the aid, others cannot receive it as it has been consumed.

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person's consumption of them clearly reduces the amount left for others."); *see also supra* note 57 and accompanying text.

     66.   *See* I.R.C. § 170(c) (West 2010); *see also Search for Charities, Online Version of Publication 78*, INTERNAL REVENUE SERV., http://www.irs.gov/app/pub-78/ (click "Search") (last visited Nov. 12, 2010) (providing a cumulative list of organizations eligible to receive tax-deductible charitable contributions); Chamberlain & Sussman, *supra* note 53, at 5 (providing list of registered section 501(c)(3) charities as of 2004).

     67.   *See* sources cited *supra* note 66.

     68.   *See supra* notes 55–56 and accompanying text.

     69.   Professor Mark Gergen conceptualizes the public good complexity as follows:

> Disaster and poverty relief also may be considered close to pure public goods if one emphasizes the benefits that accrue to society generally—e.g., insurance, relieving knowledge of other people's suffering, or easing potential social tension—and not the specific assistance given to individuals or the specific pleasure donors obtain from giving. Churches, museums, and schools are not public goods in this strict sense of the term because they benefit parishioners, patrons, and students who could be made to pay for what they receive. They may, however, be thought of as impure public goods because of their secondary benefits. The moral or intellectual education of parishioners and students indirectly benefits everyone in the community, and the presence of churches, museums, and schools makes a community a more stimulating and attractive place to live for everyone.

Gergen, *supra* note 3, at 1397–98 (citation omitted).

     70.   *See supra* notes 55–56 and accompanying text.

Thus, for purposes of this Article, one should view the public good requirement as requiring organizations to provide goods that create enough positive externalities that it makes sense to subsidize organizations providing them, so long as they meet the other criteria of subsidy theory.

Organizations that provide food to the poor clearly create many positive externalities by allowing those who could otherwise not provide for themselves to receive nourishment essential to their survival. It thus seems taxpayers should receive deductions for donations to organizations that provide these goods if other criteria are fulfilled. Consider, however, another simple example where positive externalities are created, but are not sufficient to warrant a deduction: an extremely well-dressed woman. Positive externalities might arguably be created by, for instance, making the places in which she travels more aesthetically appealing.[71] Few, however, would contend that these positive externalities are great enough that taxpayers should receive deductions for donating money to enhance her wardrobe (or to an organization which performs the same task).[72] In analyzing the presented cases, the remainder of this Article will assume that the goods or services provided by the organizations at issue fulfill this prong and will refer to them as public goods.

Having illustrated the (quasi-) public good prong of the subsidy theory analysis, this Article now turns to its second requirement.

B. Correcting Underfunding: Achieving Optimal Provision of Public Goods and an Optimal Payment Pattern

Assuming the donee-organization provides a public good, subsidy theory asserts that the government should not provide a subsidy in the form of a tax deduction unless that public good would be underfunded in the absence of a deduction.[73] Thus, if the public good would not be underfunded in the absence of the deduction, the subsidy ought not be provided.

This obviously requires one to define the circumstances under which a particular public good will be optimally funded (that is, not be underfunded). To this end, Professor Gergen employs the "benefits pricing model,"[74] under which optimal funding occurs if two conditions are met.[75] The first condition provides that a public good should be "funded at the level where the sum of the incremental

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71. Negative externalities may also be created—for instance, people may be distracted, the individual may cause feelings of envy, etc.—but this is not important for purposes of making the point.

72. Thank you to Mark Gergen for aiding me with this "eye candy" hypothetical.

73. "Charities that provide goods for which we cannot or do not wish to charge beneficiaries deserve government support because, without the subsidy, society will tend to underfund them." Gergen, *supra* note 3, at 1398.

74. *Id.* at 1400 (citing Harold M. Hochman & James D. Rodgers, *The Optimal Tax Treatment of Charitable Contributions*, 30 NAT. TAX J. 1 (1977), *reprinted in* THE ECONOMICS OF NONPROFIT INSTITUTIONS: STUDIES IN STRUCTURE AND POLICY 224 (Susan Rose-Ackerman ed., 1986)). The benefits pricing model is also referred to as the Lindahl solution. *Id.*

75. *See* ANDREW SCHOTTER, MICROECONOMICS: A MODERN APPROACH 641–42 (2009) (providing an overview of the Lindahl solution to the problem of public goods).

benefits individuals derive from the last unit of the good equals the marginal cost of that unit."[76] If funded at this level, the good is optimally provided. Second, "each individual [should] contribute[] an amount equal to her marginal benefit from the last unit of the good times the number of units provided."[77] If this condition is satisfied, an optimal payment pattern has been achieved.

Consider a simple example to illustrate the first condition. Assume that Organization C will provide a public good, P. As a result, individual A will enjoy a $5 benefit from the provision of one additional unit of P, and individual B will enjoy a $2 benefit from the additional unit provided. Organization C should provide that unit of the good so long as the cost of producing it is less than or equal to $7 (the sum of the benefits enjoyed by A and B from that additional unit). Once the marginal cost exceeds the aggregate benefits to A and B, however, Organization C should no longer provide that unit.

Assume now that it costs Organization C $7 to produce Unit 1 of public good P. A second unit (Unit 2) will also cost $7, and A and B will each derive an additional $2 marginal benefit. The optimal level of provision is to provide Unit 1, but not Unit 2. This will happen in a normal market scenario so long as A and B are rational economic actors. A rational economic actor should see no difference between receiving the good and retaining an amount of money equal to the benefit enjoyed by that good.[78] Thus, absent transaction costs, a rational purchaser will pay any amount that does not exceed the benefit the good can provide.[79] In this example, if A and B are rational actors, A will pay $5 and B will pay $2 for Unit 1, and each will pay $2 for Unit 2. Since Organization C can only cover its $7 cost for Unit 1, only that unit will be produced, which is the optimal solution. Where, as in this example, "each individual contributes an amount equal to her marginal

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76.   Gergen, *supra* note 3, at 1400.

77.   *Id.*

78.   *See* MICHAEL ANTHONY LEWIS & KARL WIDERQUIST, ECONOMICS FOR SOCIAL WORKERS: THE APPLICATION OF ECONOMIC THEORY TO SOCIAL POLICY AND THE HUMAN SERVICES 16–24 (2002) (discussing marginal analysis within the assumption of rational self-interested behavior). Explaining marginal analysis, economists Lewis and Widerquist state that "the optimal quantity is the point at which the marginal cost equals the marginal benefit." *Id.* at 21. They provide the following example:

> If a cookie costs $1, then for every cookie I eat, I have one less dollar to spend on all other goods. The marginal benefit of a cookie is a little bit trickier. You have to ask yourself how much you would pay for this cookie. What would be the *most* I would give up for this cookie if I had to? Suppose you eat one cookie and it tastes so good that you would be willing to sacrifice $4 worth of other goods to buy it. . . . Luckily, you had to pay only $1, so it was a good deal for you. So you have another. Now that you have already had a cookie, the second one is not nearly so satisfying, but it is still good—so you would pay $2 for it. Still a good deal. Now that you are becoming satisfied, the third cookie is only worth $1 to you. It costs $1 so it is worth it, but just barely. You are indifferent to this third unit. That is how you know you have reached the optimum, and it is time to stop eating cookies.

Id. at 22.

79.   *Id.*

benefit from the [goods provided],"[80] an optimal payment pattern also exists, satisfying the second condition of the benefits pricing model.

However, suppose that either A or B is no longer willing to pay an amount equal to the benefit derived from the good. The good will be underfunded, as it cannot be provided at the optimal level. The producer will not provide Unit 1 because it will not be able to cover the costs of production. This illustrates a collective action problem.

Providing a tax deduction may correct this collective action problem by creating conditions that restore optimal provision of the collective good. Assume that A is still willing to pay $5 for Unit 1 of P, but B is not willing to pay anything, even though he will benefit $2 from Unit 1's provision. Organization C will not provide the additional unit of P because its costs cannot be covered. But now assume that a taxpayer may receive a deduction for amounts spent on the public good. If A is granted a deduction that is worth $2[81] on amounts expended on P, the optimal level of production will be restored. Taxpayer A will give $7 to Organization C, as the good will have an after-tax cost of $5 ($7 minus $2), the amount A is willing to spend. Organization C will be able to cover its costs, and Unit 1 will be provided. In this way, optimal provision is restored.

Further, in this scenario, assuming that A and B are the only two taxpayers in a finite universe, an optimal payment pattern is again achieved, as both A and B can be said to have paid an amount equal to their marginal benefit from Unit 1. Specifically, A paid $5 after tax, an amount equal to his marginal benefit from Unit 1, and B can be said to have paid $2, an amount equal to his marginal benefit from that unit, by bearing the costs of A's tax savings. Here, the deduction seems entirely defensible, as nobody paid more than the benefit received from the provision of the good.[82]

The framework presented provides an essential starting point by showing how the charitable deduction can correct collective action problems, thereby correcting the underfunding that results. There are various reasons why a collective action problem of this nature might occur, and often does occur, particularly in the context of collective goods where donations fund production. For instance, suppose an organization in Smalltown wishes to raise money to build a community center for its 100,000 citizens. The center will cost $100,000. A group of fifty citizens will have a large $1000 benefit from the center and the remainder of the citizenry will reap small individual benefits of $1 each. If each citizen contributes an amount equal to his or her individual benefit, the organization will build the center because costs will be covered (that is, the aggregate benefit of $149,950

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80. Gergen, *supra* note 3, at 1400.

81. For instance, if an individual is in a 33% tax bracket, a $7 deduction would be worth just over $2.

82. The astute observer might ask how, if A and B are the only members of a democratic society, a deduction could be passed over B's objection (he is not willing to pay for the good, and therefore will not be willing to pay for the deduction). The back-scratching scheme suggested by Colombo and Hall suggests a solution to this political action problem. *See* JOHN D. COLOMBO & MARK A. HALL, THE CHARITABLE TAX EXEMPTION 107–08 (1995).

outweighs the $100,000 cost). However, there are many reasons why citizens—particularly those citizens reaping a small benefit—may not, and often do not, contribute this amount. To cite a common example, there may be a free-rider problem whereby citizens do not pay the rational price (their individual benefit) because they hope that others will fund the project, allowing the free-riding citizens to reap benefits without bearing any cost.[83] Those citizens that only reap a small individual benefit may be especially likely to free-ride, as the project is not of particular importance to them.

In this case, the deduction might "enable[] people with a high preference for a good [here, the fifty citizens reaping a large benefit] to shift some of its cost to low-preference freeriders [here, the remaining citizens who reap small benefits],"[84] who would, were they not free-riding, pay an amount equal to the benefit derived. In this way, subsidy theory promotes the minority-protecting and pluralistic notions used to justify the deduction by enabling political minorities to overcome collective action problems, thus funding projects that would not otherwise be funded in the political sphere (because politicians would cater to majority interests). In this example, the fifty citizens who would reap the greatest benefits from the center would likely not have the political power to convince lawmakers to fund the project. The remaining majority of citizens who would only receive small benefits would be unlikely to devote energy toward advocating the project's construction. As shown, however, the cost-shifting mechanism provided by the deduction, and advocated by subsidy theory, might allow this minority project to be funded.

Having discussed the public good and underfunding prongs of subsidy theory, the next Section will discuss the remaining efficiency prong of the analysis, which will be the focus of the remainder of this Article.

C. Overall Efficiency

Thus far, it has been stated that a deduction for amounts given to an organization can be justified if, and only if, the organization provides a public good that is underfunded—that is, in the absence of a deduction, individuals will not contribute enough money for the good to be optimally provided. In calculating the optimal provision level, marginal benefits were weighed against marginal costs. In calculating marginal benefits, one summed the benefits enjoyed by those who ultimately used the good and, in calculating marginal costs, one summed all costs associated with producing the good. The calculation properly accounted for costs internal to the production process but purposefully excluded other external costs. That is, the calculation did not account for costs that might be borne by

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83. *See* George Joseph Stigler, *Free Riders and Collective Action: An Appendix to Theories of Economic Regulation*, *in* THE ESSENCE OF STIGLER 67, 67–68 (Kurt R. Leube & Thomas Gale Moore eds., 1986).

84. Gergen, *supra* note 3, at 1403.

society as a whole—that is, negative externalities—if the good were to be provided.[85]

Modifying the above community center hypothetical, assume that the center costs $100,000, but that the citizens who will use it will reap a greater aggregate benefit from the center, quantified at $200,000. When one accounts for the benefits created by the center and the direct cost of providing it (for example, building costs), it seems desirable for the center to be constructed. However, assume that the center, if built, will decrease the value of neighboring houses, a negative externality. Most would agree that, at some point, the decline in property value would be too great to justify the center's construction. How to determine when that decline is, in fact, too great is debatable and depends on the model of efficiency one chooses to employ. This will be explored in Part II, which focuses on the efficiency prong of the subsidy analysis.

II. DETERMINING THE OVERALL EFFICIENCY OF CHARITABLE TRANSFERS

Subsidy theory posits that taxpayers should be entitled to a charitable deduction only when a deductible transfer from the donor-taxpayer to the donee-organization would be efficient from an overall societal perspective. There are, however, different models for determining efficiency, and it is not immediately clear which method is appropriate for determining whether a charitable deduction is justified.

Section A explores the two methods commonly used to evaluate efficiency: the Pareto method and the Kaldor–Hicks method.[86] Although the Pareto method seems to provide an ideal measure for evaluating whether a charitable deduction is justified, it is of limited use in this context, as all deductible donations will fail to be efficient under this model. In response, subsidy theorists use the Kaldor–Hicks method to analyze the deduction.[87]

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85.   *See, e.g.*, Louis Kaplow & Steven Shavell, *Property Rules Versus Liability Rules: An Economic Analysis*, 109 HARV. L. REV. 713, 719–20 (1996) (referring to social costs and externalities interchangeably).

86.   *See* THOMAS J. MICELI, ECONOMICS OF THE LAW: TORTS, CONTRACTS, PROPERTY, LITIGATION 4 (1997) [hereinafter MICELI, ECONOMICS OF THE LAW] (stating that the Kaldor–Hicks and Pareto concepts of efficiency are most commonly used in economics); THOMAS J. MICELI, THE ECONOMIC APPROACH TO LAW 4–6 (2004) [hereinafter MICELI, ECONOMIC APPROACH] (explaining that the basic definition of efficiency in economics is Pareto efficiency and that economists solve problems with the Pareto method by using the Kaldor–Hicks method).

87.   This method does not provide results useful in evaluating whether a charitable deduction is warranted in many cases where the transfer causes negative externalities. *See infra* Part II.B.

A. The Pareto and Kaldor–Hicks Models of Efficiency

Economists have devised various models to determine whether an action is efficient, with the Pareto and Kaldor–Hicks models being most commonly employed.[88]

A transfer is "Pareto efficient" if the transfer would "make at least one person better off and no one worse off."[89] To apply this model to a potentially deductible donation, assume a taxpayer donates to Organization X, which would use the funds to construct a community center that creates an aggregate benefit of $200,000 for those who can use it. The center will cost $100,000 to build. The donation will clearly make some "better off." Thus, a donation to Organization X is Pareto efficient so long as nobody is "worse off"—that is, harmed.[90] Assume now that construction of the center will cause the value of Taxpayer B's home to decline. Donations will be inefficient under the Pareto model because the donation would be used in a way that harms B. Importantly, whether the transfer would cause Taxpayer B's property to decline in value by $10 or by $1 million is immaterial under the Pareto method. The existence of a harmed party, irrespective of the magnitude of harm, causes a transfer to be inefficient under this method.[91] If this efficiency model were used, a deduction to Organization X would never be warranted.

There is a strong argument that charitable deductions should be granted only to transfers fulfilling this principle. That is, a taxpayer should only be able to deduct amounts donated to organizations that do not cause any harm to others.[92] As discussed, allowing taxpayers to claim charitable deductions for amounts donated to particular organizations is equivalent, in effect, to the government providing a direct subsidy to those organizations.[93] There is nothing particularly troubling with the government subsidizing organizations that do not cause injury.[94]

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88. *See generally* MICELI, ECONOMICS OF THE LAW, *supra* note 86 (providing a comprehensive analysis of economics in the law); MICELI, ECONOMIC APPROACH, *supra* note 86 (same).

89. ATKINSON & STIGLITZ, *supra* note 13, at 509; *see also* MICELI, ECONOMIC APPROACH, *supra* note 86, at 4 (explaining that under the definition of Pareto efficiency, "reallocations are only allowed if neither party is made worse off"); Gergen, *supra* note 3, at 1401 (stating that there is a powerful argument for a deduction or credit because a deduction means the policy makes "some people better off and no person worse off").

90. *See* sources cited *supra* note 89.

91. *See supra* note 89 and accompanying text.

92. In fact, adherence to the Pareto principle is often viewed as a baseline requirement for public policy actions. Joseph Bankman & Thomas Griffith, *Social Welfare and the Rate Structure: A New Look at Progressive Taxation*, 75 CALIF. L. REV. 1905, 1917 (1987) ("[A]cceptance of this principle is frequently considered a prerequisite of any acceptable social decision-making rule." (citing YEW-KWANG NG, WELFARE ECONOMICS: INTRODUCTION AND DEVELOPMENT OF BASIC CONCEPTS 30–32 (1980))).

93. *See* Surrey, *supra* note 7, at 726.

94. *See, e.g.*, Gary Lawson, *Efficiency and Individualism*, 42 DUKE L.J. 53, 85 (1992). Professor Lawson discusses why the Pareto model is a particularly "morally attractive model. In a Pareto superior transaction, somebody gains and nobody loses. Who could possibly object? The answer is that no one can object—by definition." *Id*. One might go further and object to using public money to facilitate transfers that are Pareto *efficient* on

The situation seems quite different, however, when government funds enrich some taxpayers while actually causing others harm by creating negative externalities.[95] Requiring transfers to be Pareto efficient ensures that this will not happen, making the Pareto model seem ideal for evaluating whether a transfer should be deductible.[96]

Realistically, however, every deductible donation will harm some group of taxpayers in some manner.[97] For instance, since the cost of the deduction is spread among all taxpayers, those who do not benefit from the goods provided by the donee-organization will suffer universal subsidization harm, illustrated fully below.[98] Further, it will almost always be the case that for any donation, some taxpayer will believe it to be foolish and will feel negative emotions about the government subsidizing the transfer and about the organization to which the donation has been made. As these taxpayers will be worse off as a result of the transfer, it is Pareto inefficient. In the context of the hypothetical above, even if B's property value were not affected, a deductible donation to Organization X would still be inefficient under the Pareto method because of these other harms. The inevitable presence of this harmed group "ensures that a deduction never can be justified as a Pareto improvement."[99] Thus, while it seems ideal for deductions

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the ground that government funds should not enrich select taxpayers, while leaving others unaffected. So-called "[e]ntitlement theories . . . may not endorse a tax that increases the welfare of an 'undeserving' individual even if that change does not reduce the welfare of any other person." Bankman & Griffith, *supra* note 92, at 1917; *see also* Frank I. Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1165, 1176 (1967) (mentioning a possible objection to the goal of efficiency and its ethical implications). *But see id.* (citing JAMES M. BUCHANAN & GORDON TULLOCK, THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY 62 (1962)) ("Implicit in the notion of efficiency is an ethical premise which few would care to dispute: that a change in the resource use which can improve the situations of some people without damaging the situations of any is desirable.").

95.   "Enormous problems exist in justifying a deduction on the ground that, although it hurts some people, it helps others more." Gergen, *supra* note 3, at 1413; *see also* Guido Calabresi, *The Pointlessness of Pareto: Carrying Coase Further*, 100 YALE L.J. 1211, 1217 (1991) (describing cases in which someone loses regardless of how desirable changes may appear to most individuals).

96.   *See* Lawson, *supra* note 94, at 85 ("If someone is disadvantaged by an action, then by virtue of that fact the action is not Pareto superior."); *see also supra* note 89.

97.   As Professor Gergen recognizes, there is a "darker aspect to this picture: Some people lose because of a deduction." Gergen, *supra* note 3, at 1412.

98.   *See infra* text accompanying notes 114–21.

99.   Gergen, *supra* note 3, at 1412; *see also* Calabresi, *supra* note 95, at 1216 (explaining that if the Pareto test had any force, "it would mean that, however bizarre or nefarious the original starting points and tastes they defined, and however outrageous the wealth and power distributions that our law created or took for granted, nevertheless existing laws could be attacked if they were not Pareto optimal"). The fact that the Pareto model will render almost all charitable contributions inefficient is not unique. "Almost nothing, and perhaps even nothing, meets the strict criteria of Pareto superiority in the real world if one is seeking to define 'efficiency' for an entire society." Lawson, *supra* note 94, at 85. This is because most transfers will cause some individual or group of individuals some sort of harm. Calabresi, *supra* note 95, at 1216–17.

to only be given with respect to Pareto-efficient transfers, an alternative model is needed unless the charitable deduction is to be repealed in its entirety[100] (or if one is willing to abandon the notion of overall efficiency altogether).

The Kaldor–Hicks model is used by subsidy theorists as the alternative measure for analyzing the charitable deduction. Formally stated, under the Kaldor–Hicks model, "[o]ne state of affairs (E′) is Kaldor–Hicks efficient to another (E) if and only if those whose welfare increases in the move from E to E′ could fully compensate those whose welfare diminishes with a net gain in welfare."[101] Simply put, one asks whether the total net benefits produced by the transfer (here the potentially deductible donation) offset the total harms caused by the same. Consider the above example, where Organization X can construct a community center for $100,000, resulting in a $200,000 benefit to those who will use it and an indeterminate decline in B's property value. A deductible donation to Organization X would be deemed inefficient under the Kaldor–Hicks model if the decline in B's property value plus the other harms produced by the donation (such as universal subsidization harm) would exceed $100,000 (the benefit less the cost of the center). Thus, if this efficiency model were used, deductions for amounts donated to Organization X would not be warranted in these circumstances. Unlike the Pareto model, however, the Kaldor–Hicks model would not render deductible donations inefficient in all cases. If the decline in property value plus the other harms produced by the donation would not exceed $100,000 (the benefit of the center less its costs), then the donation would be efficient under the Kaldor–Hicks model. Thus, if this model were used, deductible donations made to Organization X would be warranted in cases where the decline in property value was sufficiently small. By contrast, the same deduction is not justified under the Pareto model so long as there is any harm caused, regardless of its magnitude.

The Kaldor–Hicks model is a sensible measure for evaluating efficiency in many contexts. The model, for example, allows economists to make efficiency claims in situations where they are unable to quantify actual gains and losses.[102] Further, without the model, "economists would have no way to deem the gains to the winners 'larger' than the losses to the losers"[103] even where "the number of

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100. Judge Posner has stated:
> Because the conditions for Pareto superiority are almost never satisfied in the real world, yet economists talk quite a bit about efficiency, it is pretty clear that the operating definition of efficiency in economics is not Pareto superiority. When an economist says that free trade or competition or the control of pollution or some other policy or state of the world is efficient, nine times out of ten he means Kaldor–Hicks efficient.

RICHARD POSNER, ECONOMIC ANALYSIS OF LAW 3–10 (3d ed. 1986). *See generally* J. R. Hicks, *The Foundations of Welfare Economics*, 49 ECON. J. 696 (1939); Nicholas Kaldor, *Welfare Propositions of Economics and Interpersonal Comparisons of Utility*, 49 ECON. J. 549 (1939).

101. *See* JULES L. COLEMAN, MARKETS, MORALS, AND THE LAW 98 (1988).

102. *See* MICELI, ECONOMICS OF THE LAW, *supra* note 86, at 5–6 (discussing the applicability of the Kaldor–Hicks model to solve the noncomparibility problem of the Pareto model).

103. Lawson, *supra* note 94, at 90.

people who gain from an action is much larger than the number who lose."[104] Thus, the Kaldor–Hicks model preserves economists' ability to say "useful things,"[105] deeming "certain actions . . . efficient when they result[] in gains in utility or welfare for some people but losses for others."[106]

While it is clear, however, that the Pareto model cannot always be utilized to evaluate when a charitable deduction should be granted, it is not clear that the Kaldor–Hicks model always yields useful results in making this evaluation.

There are two identifiable groups whenever a taxpayer donates to a charitable organization. The transfer benefits the first group, sometimes referred to as a "high preference minority,"[107] but does not benefit the second group. When discussing the charitable deduction, subsidy theorists have focused on the instance where the second group, while not benefitted, either does not suffer any harm from the transfer or suffers minimal harm.[108] Specifically, scholarship using subsidy theory has tended to deal with the case where the harm of subsidizing a charity is limited to the general economic harms from the revenue effect of the deduction and relatively slight psychic harm suffered by individuals who must live in a world where others can deduct amounts donated to organizations those individuals view as foolish or strange. In economic terms, the harmed group is assumed to be "relatively indifferent"[109] and the organization in question does not create any harms to society other than the small negative externalities assumed.

Part II.B begins with this "assumed case" (the case upon which subsidy theorists have tended to focus) and applies the Kaldor–Hicks model to it. It shows that when harm is limited in this assumed manner, it should generally be simple for transfers to be deemed efficient under the Kaldor–Hicks model and, thus, generally simple to justify deductions when the other prongs of the framework are fulfilled. Because of this, subsidy theorists' assumption that the harmed group is relatively indifferent is, in effect, equivalent to an assumption that transfers are generally efficient. Perhaps for this reason, the efficiency prong of the theory has not been explored in sufficient depth.

After discussing the assumed case of relative indifference, this Article discusses the more difficult cases where harms are not so limited—where the harmed group is not merely relatively indifferent, and the transfers create more serious negative externalities than those assumed. These situations have not, to date, been the subject of scholarly focus. As will be illustrated through detailed examples, the Kaldor–Hicks model does not act as a sufficient tool in determining whether a charitable deduction is warranted in these important cases. As such, the

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104. *Id.*

105. *Id.*

106. *Id.*

107. *See* Gergen, *supra* note 3, at 1399 (discussing "high preference minority" and "relatively indifferent majority"); Hochman & Rodgers, *supra* note 74, at 227–28.

108. *See* Gergen, *supra* note 3, at 1399–1407 (summarizing the work of economists Harold Hochman, James Rodgers, and Burton Weisbrod). The three economists' works seem confined to the instance where a transfer does not benefit a group, but that group is either not harmed or suffers negligible harm. *Id.*

109. *Id.* at 1399.

subsidy theory cannot act as the sole justification for charitable deductions when negative externalities beyond those assumed are present.

B. The Assumed Case of Relative Indifference: Negative Externalities Limited to Universal Subsidization Harm and Slight Psychic Harms

> *Scenario 1:* Assume that Taxpayer C gives $100 to Organization C, which provides vaccines for a particular disease. D does not receive a vaccine and, in fact, lacks an opinion about the vaccines, Organization C, or anything related. If asked, however, D would find Taxpayer C's donation a somewhat foolish use of $100.[110]

In applying the Kaldor–Hicks model, one must weigh benefits against possible harms.[111] Let us first start with the harms side of the equation. There is minimal harm caused by the transfer in Scenario 1, since the harmed group (here D) is "relatively indifferent" (the case assumed by subsidy theorists).[112] One might say that D suffers psychic harm because he disapproves of how Taxpayer C spent the $100. To the extent, however, that one wishes to account for this psychic harm, it is slight.[113]

> The transfer in Scenario 1 also causes a more subtle type of harm. D has subsidized Taxpayer C's donation because he, along with all other taxpayers, absorbed the cost of C's tax deduction. D's tax rate will be higher than it would have been in the absence of a charitable deduction, as compensation for the revenue lost by the deduction necessitates a higher rate.[114] Thus, money that D would have used to further his own ends was used to fund C's donation to a charity to which he is indifferent. This universal subsidization harm occurs whenever one makes a deductible contribution because taxpayers will inevitably donate to causes to which others are indifferent.[115] The efficiency calculus must account for this harm.[116]

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110.   Recall that we are assuming that the good is public enough to fulfill the public good criterion. Vaccines do not meet the formal definition—that is, they are not non-rivalrous or non-exclusive. They do, however, create many positive externalities that seem sufficient to grant a deduction if needed to prevent underfunding. *See supra* Part II.A.

111.   *See supra* note 94 and accompanying text.

112.   Gergen, *supra* note 3, at 1399; *see also id.* at 1400–07.

113.   *Id.* at 1412 ("No matter how worthy the cause, some will complain that they do not want to help support a charity indirectly through a deduction. Some may dislike the Salvation Army because they believe that the poor are lazy and deserve to suffer in poverty. Some may oppose the Red Cross because they think it paternalistic.").

114.   *See* Surrey, *supra* note 7, at 726 (noting that both direct expenditures (government assistance) and programs funded through deductions "keep our tax rates high"); *see also* Buckles, *supra* note 46, at 951 ("[I]f all else is held constant, the availability of the charitable contributions deduction means that tax rates must be increased to compensate for the diminished income tax base.").

115.   *See* Gergen, *supra* note 3, at 1412.

116.   The astute observer might wonder how, in a democratic society, the deduction can be passed over C's objection. For a theory regarding this issue, see COLOMBO & HALL, *supra* note 82, at 107–08.

Before proceeding to this analysis, recall the example presented in Part I.B to fully understand the concept of universal subsidization harm. In that example, Taxpayer A was willing to pay $5 for Unit 1 of a public good. Taxpayer B was not willing to pay anything even though he would benefit $2 from provision of the good. This illustrated a collective action problem and resulted in the public good being underfunded. The example demonstrated that this collective action problem could be corrected, and the good optimally provided, if the government granted Taxpayer A a deduction worth $2. Further, assuming a finite universe of taxpayers consisting only of A and B, an optimal payment pattern was achieved, as both A and B could be said to have paid an amount equal to their marginal benefit from the provided unit.[117] As discussed, the deduction granted to Taxpayer A seems unobjectionable, as nobody paid more than the benefit received from the provision of the good.[118] Thus, no one suffered harm, and the transfer was even efficient under the Pareto model.[119]

Assume now, however, that Z is also a member of the universe of taxpayers and that she is not affected by provision of the public good (that is, she is indifferent). Under the same general facts of the example, Taxpayer A will pay the producer of the public good $7 and claim a deduction worth $2, allowing the organization to produce the good at the optimal level. Taxpayer A will have paid $5 for the good and the cost of his $2 tax savings will be spread between B and Z. Taxpayer B will pay less than his marginal benefit for the public good, which is optimal. Thus, the benefit B enjoys from the good's provision will outweigh his universal subsidization harm, so that he is better off. However, Taxpayer Z will pay more than her marginal benefit, presumed to be zero. This "excess" payment is Z's universal subsidization harm, as it is not outweighed by any related benefit.[120]

Having illustrated the concept of universal subsidization harm, the Kaldor–Hicks efficiency calculus can now be applied to Scenario 1. D (the relatively indifferent party) will suffer slight psychic harms and universal subsidization harm, described fully above.

A simplified analysis can be conducted by defining several variables:[121]

allow b = total benefit created by the donation;

allow d = donation;

allow c = cost of creating the benefit;

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117.   *See supra* Part I.B.
118.   *See supra* Part I.B.
119.   *See supra* Part II.A.
120.   To clarify, all taxpayers will suffer universal subsidization harm in that they will all share the cost of the deduction. However, the benefitted group will also enjoy a benefit from the donation, which may or may not be outweighed by the slice of the deduction he or she paid for in the form of a higher tax rate.
121.   The equations presented are oversimplified and do not account for other variables. They, for instance, disregard the opportunity cost of the taxpayers suffering universal subsidization harm. In Scenario 1, the equation does not account for the fact that D not only paid for a part of C's donation, but that he might have invested that money, generating future income. Reaching this level of complexity is unnecessary here, as Equation 1, simplified as it is, allows the desired point to be made.

allow h = harm caused by the transfer;

allow u = universal subsidization harm;

allow t_n = marginal tax bracket of taxpayer n;[122]

allow d_n = donation made by taxpayer n;

then $u = t_1 d_1 + t_2 d_2 + \ldots + t_n d_n$.

In Scenario 1, only one taxpayer (C) donates and, if one assumes his marginal tax rate to equal t, then u = td. (Alternatively, one could assume all taxpayers making relevant donations have the same tax rate.)

With this assumption, the transfer in Scenario 1 will be efficient when the net benefits created by the donation exceed the harm caused. Thus, the transfer will be efficient when:

$b - c > h$.

The harm to the donor (here C) is the after-tax cost of the donation, or $(1 - t)d$. Ignoring the psychic harms suffered by D (the relatively indifferent party) for simplicity and because it is so slight as to not have a meaningful impact on the calculations, the only other harm suffered is D's universal subsidization harm. Thus, the transfer will be efficient if:

$b - c > u + (1 - t)d$.   (Eq. 1)

When harm is confined in this assumed manner, it would seem quite simple for most donations to meet this equation and be deemed efficient under the Kaldor–Hicks framework.

To see why, one needs to unpack the total benefit created by the donation (variable b) into two components:

allow b_s = benefit created by d (the donation) to members of society other than the donor;

allow b_d = benefit enjoyed exclusively by the donor because of his donation (d);

then $b = b_s + b_d$.   (Eq. 2)

Variable b_s represents the positive externalities, or benefits, shared by members of society (other than the donor) as a result of the donation. In Scenario 1, the most obvious benefits are those resulting directly from the use of the donated funds. One would first need to quantify the direct benefits by assigning value to the improved health of those vaccinated. One could also imagine other secondary benefits, perhaps looking to the benefits enjoyed by a society that now has a lesser occurrence of a certain disease, such as improved work productivity and lower health care costs.[123]

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122.   One's marginal tax bracket refers to the tax rate at which one's last dollar of income would be taxed. It allows one to quantify the dollar effect of the deduction.

123.   In discussing the idea of secondary benefits, Professor Gergen provides the following example: "The moral or intellectual education of parishioners and students

The variable b_d represents the benefit that the donor (here C) enjoys as a result of his donation. Much has been written on the benefits donors may receive when donating money or engaging in "other-regarding" transfers such as gifts. First, the donor may, as a member of society, benefit from the organization's use of the funds (C may, for instance, receive a vaccine from Organization C). Further, the donor may enjoy a psychic benefit from making the donation—if he "feels good" for having done so—often referred to as the "warm glow" effect.[124] Here one can easily imagine C experiencing some sort of "warm glow"[125] and pride from giving to an organization with a purpose in which he believes. There is also another less obvious effect—the donor may indirectly benefit from the beneficiary's increase in welfare.[126] Here, C may derive further utility from knowing that his donation has prevented the illness of others (that is, his utility is increased by the beneficiaries' increase in utility).[127]

Under fundamental economic assumptions, a donor will not make a donation unless the various benefits he receives have an intrinsic worth to him that is at least equal to the after-tax cost of the donation; otherwise the donor would be acting in an economically irrational manner.[128] Let us assume, then, that b_d is equal to the donor's after-tax cost of giving, or $(1-t)d$.

Incorporating these concepts, the transfer is efficient if:

$b - c > u + (1-t)d;$ (Eq. 1)

$b_s + b_d - c > u + (1-t)d;$ (using Eq. 2)

$b_s + (1-t)d - c > u + (1-t)d;$

$b_s - c > u;$

$b_s - c > td.$

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indirectly benefits everyone in the community, and the presence of churches, museums, and schools makes a community a more stimulating and attractive place to live for everyone." Gergen, *supra* note 3, at 1398. Certainly, there is ample room to debate what types of benefits should be included in the Kaldor–Hicks calculus. For an interesting discussion of psychic benefits, see *id.* at 1407–12. Resolving this debate, however, is not necessary here because the purpose of the scenario is to illustrate concepts, not to perform actual calculations. The scenario demonstrates what scholars mean when referring to the benefits created by a charitable transfer, and thus exemplifies the sorts of items that appear on the "benefits side" of the Kaldor–Hicks equation.

124. *See, e.g.*, Colombo, *supra* note 4, at 672 (describing "warm glow giving," wherein a donor is motivated by deriving personal pleasure from having been the instrument by which another person's welfare has been increased). Columbo adds, "The 'warm glow' may also be derived from the gratitude of the recipient to the donor." *Id.* at 672–73; *see also* James Andreoni, *Giving with Impure Altruism: Applications to Charity and Ricardian Equivalence*, 97 J. POL. ECON. 1447, 1447–52 (1989) (finding that people receive a "warm glow" from giving); Louis Kaplow, *A Note on Subsidizing Gifts*, 58 J. PUB. ECON. 469, 469 (1995) ("Presumably, altruism is an important motivation for many gifts.").

125. *See* sources cited *supra* note 124.

126. *See* Kaplow, *supra* note 124, at 470 ("[T]he donor's utility . . . depends . . . on the donee's utility.").

127. *Id.*

128. *Id.*

In other words, so long as the net benefit of the donation to society exceeds the product of the donated amount and the donor's tax rate (which is the universal subsidization harm), the transfer will be deemed efficient. If, for instance, a donor has a tax rate of 33%, the net societal benefits of the donation need only be 33% of the donated amount for the transfer to be efficient and for a deduction to be warranted under subsidy theory.[129]

This shows that when harm is limited in such an assumed manner, it should generally be simple for transfers meeting the other prongs of the subsidy analysis to be deemed efficient under the Kaldor–Hicks model and, thus, generally simple to justify deductions. Most importantly, these transfers concern the provision of goods, which meet the (quasi-) public good prong described above. Considering the number of individuals likely to benefit from goods sufficiently displaying the properties of non-excludablity and non-rivalrousness, it would seem rather simple for donations to organizations providing these goods to provide net benefits exceeding the product of the original donation and the donor's tax rate, thereby fulfilling the equation developed. In Scenario 1, for instance, one assumes that the donation will help multiple individuals avoid illness as a result of receiving vaccines. One would think this benefit would easily exceed the product of the original donated amount and the donor's tax rate. In fact, to the extent this does prove difficult, it seems that the good provided would be unlikely to be "public enough" to pass the first prong of the subsidy theory framework, rendering analysis of the third efficiency prong unnecessary. In light of this, subsidy theorists' assumption that the harmed group is relatively indifferent seems closely equivalent to an assumption that transfers meeting the other prongs of the subsidy analysis will generally be efficient.

In this assumed case, taxpayers are not harmed by the organization to which the transfer is made, and the psychic harms and universal subsidization harm resulting from the tax deduction are not particularly severe. In other words, the organization to which the donation is made does not create any negative externalities. Realistically, however, the universe of harmed parties is not confined in this assumed manner,[130] and the donee-organization may cause (possibly serious) harm to some group of taxpayers.[131] Thus, there are many cases where one has to account for additional items on the harms (right) side of the developed equation, and it will not be so simple for the transfer to be deemed efficient.

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129. Put another way, if we assume $c = d$ (because the cost of producing the benefit is the donation) then the transfer will be efficient under the Kaldor–Hicks method, and a deduction warranted, if the benefit to society exceeds the sum $(td + d)$. Thus, the value created beyond the donation need only be the product of the donor's tax rate and the donation (in this example, 33% of the donation). Considering the nature of collective goods, described above, this should not be difficult to achieve. Once again, the Author recognizes that this equation is oversimplified but hopes that it demonstrates the basic point that an application of the Kaldor–Hicks model to transfers that both fulfill the other subsidy theory prongs and concern relatively indifferent harms will very often result in the donations being deemed efficient and a deduction warranted.

130. As Professor Gergen recognizes, there is a "darker aspect to this picture: Some people lose because of a deduction." Gergen, *supra* note 3, at 1412.

131. *Id.*

Subsidy theorists, and scholars in general, have not considered how to analyze the case for a charitable deduction when other negative externalities exist. The remainder of this Part will discuss and analyze these previously unaddressed scenarios.

C. Relaxing Subsidy Theory's Assumptions and Considering Negative Externalities

This Section will present various cases in which organizations cause negative externalities beyond those assumed by subsidy theorists. Because other theories that analyze the charitable deduction similarly fail to take into account negative externalities caused by donee-organizations,[132] this Article's discussion regarding charities that cause harm is applicable to an analysis under these other theories as well.

Before proceeding, it seems worthwhile to clarify that this Article will concern itself with affirmative harms—harms in which the organization in question actually worsens the position of certain individuals. It will not focus on other less traditional harms, such as displacement harms and foregone benefits.

A brief explanation of these latter harms will suffice. Consider the following:

> *Scenario 2:* This year, Taxpayer C donated $100 to Organization 1, which provides vaccines for mumps. There exists another organization, Organization 2, devoted to feeding the poor.

In assessing harms one might argue that the transfer caused harm to Organization 2 because the one hundred dollars donated to Organization 1 might have been donated to Organization 2, resulting in "displacement harm." Like subsidization harm, displacement harm is universal. Indeed, a donation to one charity might always be argued to take a donation away from another. Whenever an individual contributes to a particular organization, all other organizations might claim that they may have received the donation. Under the practical facts of Scenario 2, however, displacement harm is extremely speculative because there is no particular reason to think that C would have donated to Organization 2 had she not donated to Organization 1. The goals of feeding the poor and providing

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132.   For instance, Mark Hall and John Colombo present an intriguing theory regarding the deduction and "why the majority of the electorate would go along with such a subsidy" of public goods to which they attach little or no value. *See* COLOMBO & HALL, *supra* note 82, at 107–08. They posit that donors are able to donate to certain organizations because of a complex "back-scratching" scheme in which B agrees to allow A to deduct contributions to A's favorite organization because A has a similar problem with B's favorite organization. *Id.* While this might justify why "opera lovers are willing to scratch the backs of ruffled grouse lovers so long as the favor is returned," Fleischer, *supra* note 25, at 213 (citing COLOMBO & HALL, *supra* note 82, at 108), this theory, to the extent it should be used to justify a deduction, cannot alone justify deductions for organizations causing large negative externalities (nor does this Article suggest that either Hall or Colombo would extend their theory this far). Like most theories, Hall and Colombo's theory does not contend with these situations.

vaccines, respectively, are quite unrelated to one another.[133] Thus, if one wanted to account for displacement harm, it would have a negligible effect on the efficiency calculus, since it would be discounted by an extremely low probability factor.[134]

One could identify circumstances in which this harm is more likely to occur. For instance, displacement harms will be more likely to occur when direct competition exists among organizations. Discussing the circumstances in which competition is most severe, economists explain that "[o]rganizations [sharing] certain attributes (issues, markets, members, resources) tend to compete with one another."[135] The degree to which organizations compete depends on, among other things, an organization's level of autonomy.[136] Autonomy refers to "the extent to which an organization possesses a distinctive area of competence, a clearly

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133. This assumes that individuals make donations based on causes that an organization pursues. Being an extremely personal decision, it would be foolish to assume all individuals donate in the same fashion. However, it seems extremely likely that a large majority of taxpayers consider an organization's causes. Some websites purportedly advising taxpayers on how to give wisely generally assume it to be so. *See, e.g.*, Joellen Perry, *Directory of America's Charities, Step 2: Choose the Charity*, USNEWS.COM, http://www.usnews.com/usnews/biztech/charities/articles/step2.htm, (last visited Oct. 1, 2010) (suggesting that, when choosing a charity, one should first "select[] a cause and [find] groups that appear to be working toward the same goal"); Shelley Elmblad, *How to Choose a Charity: Find a Non Profit for Charitable Donations*, SUITE101.COM (Mar. 21, 2007), http://personalbudgeting.suite101.com/article.cfm/how_to_choose_a_charity ("To choose a charity you need to decide what type of cause you want to contribute to, if the charity uses financial resources responsibly and how you want to make donations."); Suzanne E. Coffman, *Tips for Choosing a Charity: A Donor's 10-Step Guide for Giving Wisely*, GUIDESTAR.COM (Dec. 2005), http://www.guidestar.org/rxa/news/articles/2005/tips-for-choosing-a-charity-a-donors-10-step-guide-to-giving-wisely.aspx?articleId=794 (advising taxpayers to start their decision process by asking "What is important to me? The environment? Education? Hunger? Animal welfare? Helping sick children?;" to "[f]ocus on [the charity's] mission;" and to "[c]ompare apples to apples" by "compar[ing] charities that do the same kind of work"). In addition, websites that evaluate charities to help donors make more informed decisions generally group charities by "cause" or "mission." *See, e.g.*, CHARITY NAVIGATOR, http://www.charitynavigator.org/ (last visited Oct. 1, 2010) (explaining that the navigator "works to advance a more efficient and responsive philanthropic marketplace by evaluating the financial health of over 5500 of America's largest charities" and directing users to "browse by category," which includes the option of nine general causes); CHARITY GUIDE, http://www.charityguide.org/ (last visited Nov. 12, 2010) (providing evaluations of charities, which are sorted by category or mission); *Top-Rated Charities*, AM. INST. OF PHILANTHROPY, http://www.charitywatch.org/toprated.html (last updated Sept. 17, 2010) [hereinafter CHARITY WATCH] (same).

134. In calculating the expected harm, the dollar value of the harm would be multiplied by the probability of that harm occurring. Considering the speculative nature of the harm, an extremely low probability factor would discount the dollar value so that the final figure would be marginal.

135. Peter B. Clark & James Q. Wilson, *Incentive Systems: A Theory of Organizations*, 6 ADMIN. SCI. Q. 129, 156 (1961). *See generally* Marco A. Castaneda et al., *Competition, Contractibility, and the Market for Donors to Nonprofits*, 24 J.L. ECON. & ORG. 215 (2008) (discussing the theoretical and empirical effects of competition on nonprofits).

136. *See* Clark & Wilson, *supra* note 135, at 156.

demarcated clientele or membership, and undisputed jurisdiction over a function, service, goal, issue, or cause."[137] Thus, an organization that is capable of providing a unique public good for which there is no suitable substitute will have little competition. On the other hand, if organizations serve similar purposes, they will compete and the probability of displacement harm occurring will increase.

Suppose, for instance, that in Scenario 2, C was deciding whether to donate to an organization that provided vaccines for mumps (Organization 1) or to an organization that provided vaccines for measles (Organization 3). Suppose that C decided to donate to Organization 1. There is a stronger argument that C might have donated to Organization 3 (vaccinating for measles) had she not donated to Organization 1 (vaccinating for mumps).[138] The possible displacement harm suffered by Organization 3 in this scenario is more probable than that occurring in Scenario 2 because the organizations have similar purposes and so may compete for donations.

With displacement harms more probable,[139] related harms will also be more likely to result. Specifically, by not receiving the donation, Organization 3 cannot help those it might have helped with the displaced funds, arguably resulting in harm akin to foregone benefits.[140]

While the question of whether and how to account for such harms would be an interesting topic for further discussion, this is not the type of negative externality with which this Article is concerned. In Scenario 2 and the modified example, the transfer did not affirmatively worsen the positions of the harmed group. Instead,

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137. *Id.* at 158.

138. Websites evaluating charities usually sort by these general categories. *See, e.g.*, CHARITY GUIDE, *supra* note 133 (separating charities by the following six categories: animal welfare; children's issues; community development; environmental protection; health and safety; and poverty); CHARITY NAVIGATOR, *supra* note 133 (sorting charities by following nine categories: Animals; Environment; International; Arts, Culture, Humanities; Health; Public Benefit; Education; Human Services; and Religion); CHARITY WATCH, *supra* note 133 (separating charities among more specific categories including: abortion and family planning; AIDS; cancer; and terminally or chronically ill).

139. Even if unreduced by a probability factor, the benefit enjoyed by the organization receiving the donation will counteract the displacement harms of non-recipient organizations in the Kaldor–Hicks calculus. In this scenario, for example, if Organization D suffered a certain displacement harm of $100, there would be a counteracting $100 gain to Organization C, which received the donated amount. Discussing displacement harms remains important, however, because determining the circumstances in which they are likely to occur allows one to determine the circumstances in which other harms that flow from them, such as foregone benefits, occur.

140. In traditional cost-benefit analysis, "forgone benefits are but one type of cost, and forgone costs are simply benefits." Eyal Zamir & Barak Medina, *Law, Morality, and Economics: Integrating Moral Constraints with Economic Analysis of Law*, 96 CALIF. L. REV. 323, 333 (2008). This harm is often discussed in the business context, where foregone benefits take the form of lost profits. *See, e.g.*, Ass'n of Data Processing Serv. Orgs. v. Camp, 397 U.S. 150, 152 (1970) (holding that the plaintiff, a data processing company, had alleged injuries sufficient to confer standing when it alleged "that competition by national banks in the business of providing data processing services might entail some future loss of profits").

the potential beneficiary group of a particular organization might have received help were it not for a donation to another organization.[141]

The remainder of this Article is concerned with affirmative negative externalities—that is, situations in which the organizations in question create affirmative harm. Two affirmative negative externalities will be discussed. First, this Article will discuss cases where charitable organizations cause negative externalities through exclusion policies. It will then discuss cases where harms are caused by the efforts of organizations to promote competing viewpoints on societal issues. This part will analyze these transfers under the Kaldor–Hicks model offered by subsidy theorists and show that this model cannot act as a sufficient tool for determining whether a charitable deduction is justified when the charities in question cause these negative externalities. As such, one must reach beyond the economic models to analyze this problem.

In discussing these two cases, this Article will formulate two principles that might be used to fill the gap and contend with situations where charities cause harm. This is meant merely to be a starting point for discussion of this important issue and is by no means pretending to offer a complete solution to the problem. To reinforce this point, this Article will refer to the suggested gap-filling principles as "preliminary principles." Finally, this Article will not discuss constitutional issues that might emerge, reserving this for those with expertise in the area.

1. Negative Externalities Caused by Exclusion Policies

Scenario 3: Assume that there are two groups: Race A and Race B. Assume Race A, whose members drastically outnumber the members of Race B, would prefer not to associate with members of Race B. Race A establishes a religious organization. The organization enforces a policy, which excludes members of Race B. Taxpayers donate to the organization.

There is nothing in section 170(c) that would directly prevent taxpayers from claiming deductions for the amounts donated to this organization.[142] In general, the primary requirement for claiming a charitable deduction is that the taxpayer's donation is contributed to an organization with one of the purposes set forth in that section (which includes organizations organized and operated for religious purposes).[143] Nothing on the face of the tax code explicitly takes into account the negative externalities caused by the exclusion policy described.[144]

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141. There seems to be a "substantial moral difference between actively harming a person and not aiding her (often labeled the doing/allowing distinction)." Zamir & Medina, *supra* note 140, at 332. Some economic theories make this distinction, while others do not. Although deontologism recognizes the difference, "consequentialism seems to disregard the intuitive distinction between harming a person to prevent comparable harms befalling other people, and harming a person to further improve other people's well-being." *Id.*

142. *See* I.R.C. § 170(c) (West 2010).

143. *Id.* There are other requirements that are not immediately implicated in this scenario.

144. There are some narrow limitations on the ability of schools to engage in

The Kaldor–Hicks model also seems to act as an insufficient tool to determine whether taxpayers should be able to deduct amounts donated to this hypothetical organization. Clearly, the negative externalities in this example extend far beyond what is assumed by subsidy theorists in the case of relative indifference. The Kaldor–Hicks model, while taking into account negative externalities to some extent, seems to do so inadequately in this situation. In order to conduct the analysis, one would have to first look at the benefits of the donations (that is, the positive externalities created by the organization's use of the donated funds). This would require one to account for the benefits created by the church as well as the benefits Race A members "enjoy" by not having to associate with members of Race B. One would then have to account for the negative externalities caused by the exclusion policy. Some may immediately suggest that such items are extremely difficult, if not impossible, to quantify. While a valid point, it is not the most important one. Even if it were possible to quantify these harms and benefits, the model does not ask the right questions for determining whether a deduction is warranted.

When the Kaldor–Hicks model is applied, it is possible that the benefits enjoyed by Race A members might outweigh the harms suffered by the Race B members for the sole reason that members of Race A so greatly outnumber Race B. This would, under the model, imply that donations to Race A's religious organization should be deductible. This illustrates a general problem with using the model to analyze the charitable deduction: so long as the benefitted group is sufficiently larger than the harmed group, a deduction (that is, a subsidy) might be justified no matter how egregious or profound the harm caused may be.

Furthermore, the Kaldor–Hicks model cannot account for the "thickness" or "thinness" of the preferences involved. Most simply, suppose that members of Race A do not have a particularly strong opinion about whether or not they associate with members of Race B, but have a mild preference to avoid such associations. Suppose, however, that members of Race B have an extremely strong preference to not be excluded from places based on the color of their skin. If members of Race A sufficiently outnumber members of Race B, their many "thin" preferences might outweigh the small number of "thick" preferences of Race B, simply because of the relative sizes of the two groups.

More thorny issues emerge if one looks at the nature of the preferences involved. There seems to be, for instance, a qualitative difference between the harm (no matter how strongly felt) one might experience by having to live in a world where one must associate with individuals with whom one would rather not associate and the harm one might experience by being excluded from participating in an organization because of the color of one's skin. Conversely, there seems a qualitative difference between the benefit experienced by not having to associate with someone with whom one does not wish to associate and the benefit experienced by being able to participate in society as one pleases. The Kaldor–Hicks model cannot account for these differences, and the many "thin" benefits experienced by the larger group may outweigh the several thick harms suffered by

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racial discrimination while retaining their tax subsidies. See *infra* notes 147–155 and accompanying text for a discussion of *Bob Jones*.

the excluded group. This latter point—which makes qualitative differentiations among preferences—is thorny to say the least, and this Article in no way seeks to do more than identify the issue and show that the Kaldor–Hicks model cannot account for these differences.

Without having to further expound on this, one sees that the Kaldor–Hicks model cannot sufficiently analyze situations in which negative externalities are of this nature, rather than of the mild nature assumed in the case of relative indifference. It seems, even from a common sense perspective, that there should be some limit to the types of harm that the government subsidizes. The Kaldor–Hicks model does not provide adequate limits. One possible limiting principle would require that the government not subsidize organizations that impinge on an individual's ability to live a full and meaningful life[145] as a fair and equal member of society.[146] If this (or some version of this) first preliminary principle is accepted, taxpayers should not receive deductions for amounts donated to organizations that curtail anyone's ability to live in the prescribed manner. This would not require one to get into the thorny morass of valuing preferences but would serve as a limit to the types of harms that could be subsidized with public funds.

Applying this suggested principle to the example above, the deduction would most certainly be deemed inappropriate. Hindering one's ability to matriculate at a university based on skin color seems to impinge on one's ability to live a full and meaningful life as a fair and equal citizen. Current law accords with the suggested principle only to a limited extent.

In the now famous case of *Bob Jones University v. United States*,[147] the university had an official policy of permitting unmarried African-Americans to enroll as students but denying "admission to applicants engaged in an interracial marriage or known to advocate interracial marriage or dating."[148]

The Supreme Court removed the university's tax-exempt status[149] so that individuals could not deduct amounts contributed to the university until the policy was changed. The IRS had previously enacted a revenue ruling dealing with the

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145. This (and the second preliminary principle described below) is derived from John Rawls's notions of a well-ordered democratic society. *See* RAWLS, supra note 16, at 18. This Article's usage of these principles is by no means intended to make a philosophical judgment as to whether these notions are appropriate as overall societal goals. The principles seem to provide a sensible "floor" for limiting the harms that the government might subsidize and are used for that narrow purpose only.

146. *Id.* at 19. In John Rawls's words, a person should be able to "take part in, or . . . play a role in, social life, and hence exercise and respect its various rights and duties. Thus, we say that a person is someone who can be a citizen, that is, a normal and fully cooperating member of society over a complete life." *Id.* at 18. For an interesting article that draws on Rawls's distinction between "right" and "good" in discussing the challenge of defining a substantive standard that accounts for changes in social efficacy, see generally Iris J. Goodwin, *Ask Not What Your Charity Can Do for You:* Robertson v. Princeton *Liberal-Democratic Insights into the Dilemma of* Cy Pres *Reform*, 51 ARIZ. L. REV. 75 (2009).

147. 461 U.S. 574 (1983).

148. *Id.* at 581.

149. *Id.*

same general facts, which provided in relevant part that "a school not having a racially nondiscriminatory policy as to students is not 'charitable' within the common law concepts reflected in sections 170 and 501(c)(3) of the Code . . . and accordingly does not qualify as an organization exempt from federal income tax."[150] The Supreme Court's holding and the IRS ruling both accord with the suggested preliminary principle. Not allowing taxpayers to deduct amounts donated to Bob Jones University and organizations with similar policies would ensure that the government does not subsidize organizations that impinge on the ability of individuals to live as free and equal members of society.

To reach that result, however, the Supreme Court grafted an extremely narrow public policy exception.[151] The Court seemed to take pains to express the narrowness of its decision. Rather than merely holding that racial discrimination clearly violates public policy, it based its decision on a meticulous reliance on Supreme Court precedent, outlining the history of its decisions regarding similar issues. It stated:

> Prior to 1954, public education in many places still was conducted under the pall of *Plessy v. Ferguson*; racial segregation in primary and secondary education prevailed in many parts of the country. . . . Over the past quarter of a century, every pronouncement of this Court and myriad Acts of Congress and Executive Orders attest a firm national policy to prohibit racial segregation and discrimination in public education.
>
> An unbroken line of cases following *Brown v. Board of Education* establishes beyond doubt this Court's view that racial discrimination in education violates a most fundamental national public policy, as well as rights of individuals.[152]

Thus, the *Bob Jones* Court makes clear that its finding is based on previous case precedent, which would essentially prohibit a contrary finding. The Supreme Court's holding seems purposefully narrow. In fact, it is not even clear from *Bob Jones* that the Court would find that race-based exclusion policies would "contravene[] public policy" in all circumstances.[153] In a footnote, the Supreme Court makes this very suggestion, writing:

> We deal here only with religious *schools*—not with churches or other purely religious institutions; here, the governmental interest is in denying public support to racial discrimination in education. As noted earlier, racially discriminatory schools "exer[t] a pervasive

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150.   Rev. Rul. 71-447, 1971-2 C.B. 230.
151.   *See Bob Jones*, 461 U.S. 574.
152.   *Id.* at 592–93 (citations omitted). For a more thorough discussion of the Supreme Court's reasoning in *Bob Jones*, see Johnny Rex Buckles, *Reforming the Public Policy Doctrine*, 53 U. KAN. L. REV. 397, 400–03 (2005).
153.   *Bob Jones*, 461 U.S. at 585. Importantly, the IRS has used the public policy exception to deny tax-exempt status to other organizations engaged in race-based discrimination and in certain other limited contexts. For a summary of the IRS's relevant rulings, see Buckles, *supra* note 152, at 404–07.

influence on the entire educational process," outweighing any public benefit that they might otherwise provide.[154]

Thus, the Supreme Court expressly and deliberately leaves open the possibility that even race-based exclusion policies might not be deemed to contravene public policy if practiced by an organization other than an educational one.[155] While the IRS has ruled that certain non-educational organizations that engage in race-based discrimination may not retain tax-exempt status (and, therefore, may not maintain their ability to receive deductible contributions), it has not generally dealt with exclusion policies other than those based on race.[156] Since it seems one cannot rely on *Bob Jones* or current IRS rulings to disallow deductions in cases where negative externalities are created by non-race based exclusion policies, additional principles are needed to analyze these situations.

For instance, the Boy Scouts of America "provides a program for young people that builds character, trains them in the responsibilities of participating citizenship, and develops personal fitness."[157] The Boy Scouts of America "specifically forbid membership to homosexuals,"[158] finding that "homosexual conduct is inconsistent with the values it seeks to instill."[159]

Taxpayers may deduct amounts contributed to support the Boy Scouts.[160] Unlike the case of racial discrimination in schools, the Supreme Court and IRS have not intervened to prevent this result. For the same reasons it was not sufficient to analyze Scenario 3, the Kaldor–Hicks model is not sufficient for analyzing whether this is appropriate. However, if one accepts the principle that the government should not subsidize organizations that impinge on one's ability to live a full and meaningful life as a fair and equal citizen, allowing taxpayers to

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154.   *Bob Jones*, 461 U.S. at 604 n.29 (citations omitted).
155.   Professor Buckles notes that "[j]udicial decisions following *Bob Jones* add little to the doctrine espoused by the Supreme Court." Buckles, *supra* note 152, at 403. For more on the issue of how the court might rule in cases of racial discrimination in religious organizations, see Martha Minnow, *Should Religious Groups be Exempt from Civil Rights Laws?*, 48 B.C. L. REV. 781, 783–92 (2007), which discusses whether a religious organization should lose its tax-exempt status for discriminatory treatment and focuses on the conflict that may arise between religion and equality.
156.   *See, e.g.*, Buckles, *supra* note 152, at 405–06 (describing several memoranda and rulings in which the IRS addressed the public policy limitation on tax exemption for entities—both educational and otherwise—with race-based classifications).
157.   BOY SCOUTS OF AMERICA, http://www.scouting.org (last visited Aug. 31, 2010).
158.   *Boy Scouts of Am. v. Dale*, 530 U.S. 640, 645, 665 (2000).
159.   *Id.* at 644, 654.
160.   *Donor Opportunities*, BOY SCOUTS OF AM. NAT'L FOUND., http://www.scouting.org/sitecore/content/BSAFoundation/DonorOpportunities.aspx (last visited Oct. 4, 2010). The Boy Scouts of America National Foundation is a sister organization that "financially support[s] the mission, values, and programs of local councils of the Boy Scouts of America and Scouting organizations throughout the world by promoting and soliciting gifts, grants, and matching funds from individuals, corporations, and foundations interested in supporting Scouting both nationally and internationally." *BSA National Foundation*, BOY SCOUTS OF AM., http://www.scouting.org/scoutsource/bsafoundation.aspx (last visited Oct. 4, 2010).

deduct amounts donated to the Boy Scouts, which excludes homosexuals, seems just as inappropriate as allowing taxpayers to deduct amounts donated to universities that exclude individuals due to race-based criteria.

2. Negative Externalities Caused by Competing Versions of "The Good"

Scenario 4: Assume that Organization G seeks to pass legislation that would make it illegal to hunt on grounds on which it is currently permitted. Assume Organization H would seek to oppose that legislation in order to preserve hunting on the grounds in question. Assume that donations are used by each of the groups to pursue their legislative aims. Finally, assume Group G supports the goals of Organization G, believing that hunting should be prohibited in the areas in question. Group H supports the goals of Organization H. G, a member of Group G, donates to Organization G.

Like Scenario 3, this scenario involves negative externalities that extend beyond those assumed in the case of relative indifference. Both Organizations G and H seek to promote their contradicting versions of what is desirable in society through legislation. Thus, the furtherance of Organization G's purpose causes results that contradict the purpose of Organization H (and vice versa). As a result, when a donation is made to Organization G (as in this scenario) and used to further its purpose, its supporters will benefit but Organization H's supporters, Group H, will be harmed.

The Kaldor–Hicks analysis seems insufficient to determine whether G should be able to deduct amounts donated to Group G, or more generally, whether donors should be able to deduct amounts donated to organizations that seek to change legislation to promote their particular view of what is desirable. Without the need for direct quantification, should Group G's purpose be furthered, Group G will enjoy benefits from living in a world where an activity it opposes is prohibited. However, Group H will be harmed, since it will now be costlier for Group H to pursue hunting activities. (The reverse would be true for donations to Organization H used to advance its purpose. In that case, Group G would suffer harm from living in a world where hunting is allowed in areas where it believes it should not be, and Group H would enjoy its hunting activities.)

Assume now that Group G is much larger than Group H. The donation to Organization G may be Kaldor–Hicks efficient under these assumptions simply because the members of the benefitted group greatly outnumber the members of the harmed group. If deductions were justified whenever transfers were Kaldor–Hicks efficient, a deduction for amounts donated to Organization G might be deemed proper and a deduction for amounts donated to Organization H deemed improper, solely because of the relative size of the competing groups.

To generalize, if one organization has a support base sufficiently larger than that of an organization pursuing opposing aims, a transfer to the latter organization might be deemed inefficient simply because the large number of harms might outweigh the small number of benefits. Conversely, a donation to the former organization could often be deemed efficient because the large number of

benefits could often outweigh the small number of harms. The Kaldor–Hicks model would, therefore, have a tendency to grant deductions for donations made to groups with the largest support bases and deny deductions for donations made to groups with less support. This would undermine the goals of the charitable deduction—the same goals promoted by subsidy theory—discussed in Part I. The Kaldor–Hicks method would perpetuate the tyranny of the majority that the deduction is supposed to prevent.[161] Rather than promoting pluralism,[162] reliance on the Kaldor–Hicks method would undermine the ability of organizations with small support bases to receive aid.[163] Instead, only the most powerful organizations would be able to receive deductible contributions, a result which runs counter to the goals of the charitable deduction (and intuitively seems inappropriate).[164]

Furthermore, as discussed above, the Kaldor–Hicks model cannot account for thick and thin preferences. In this hypothetical, for instance, it is possible that members of Group G have only a mild preference that hunting be prohibited, whereas members of Group H may feel hunting to be an essential part of their lives, such that the prohibition of hunting would cause them great harm. The Kaldor–Hicks model cannot account for this, and if Group G is sufficiently large, the many thin preferences of Group G members might outweigh the much smaller number of thick preferences of Group H members. This problem could arise to a much greater extent in other contexts. For instance, consider the following:

> *Scenario 5:* Organization F is "a broad-based coalition of California families, community leaders, religious leaders, pro-family organizations and individuals . . . who have joined together to support"[165] a proposition which would add the following language to the California Constitution: "only marriage between a man and a woman is valid or recognized in California."[166] Group E engages in similar efforts to oppose the proposition. Groups F and E support Organizations F and E, respectively. F, a member of Group F, donates to Organization F.[167]

Like the hunting scenario, there are two organizations whose legislative aims oppose one another. Thus, the furtherance of Organization F's purpose causes results contrary to that of Organization E (and vice versa). It is possible that

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161.   *See* Wiedenbeck, *supra* note 28, at 96–99.

162.   *Id.*

163.   *See id.*

164.   *See* Bittker, *supra* note 25, at 46.

165.   *About ProtectMarriage.com*, PROTECTMARRIAGE.COM, http://protectmarriage.com/about/organization (last visited Sept. 16, 2010).

166.   *About Prop. 8*, PROTECTMARRIAGE.COM, http://protectmarriage.com/prop8 (last visited Sept. 16, 2010).

167.   This scenario is patterned after the Proposition 8 controversy in California. *See* Jesse McKinley & Kirk Johnson, *Mormons Tipped Scale in Ban on Gay Marriage*, N.Y. TIMES, Nov. 15, 2008, at A1. For an excellent discussion of the involvement of the Mormon Church in the passage of Proposition 8, see generally Brian Galle, *The LDS Church, Proposition 8, and the Federal Law of Charities*, 103 NW. U. L. REV. COLLOQUY 370 (2009).

members of Group F (who support the passage of the proposition) have only a mild preference that they live in a world in which members of the lesbian, gay, bisexual, and transgender (LGBT) community cannot marry,[168] whereas members of the LGBT community might have a very strong preference that they be able to marry the partner of their choosing.[169] Further, even if this is not so, there may be a qualitative difference between the possible harms members of Groups F and E would suffer if contrary aims were advanced. One could argue that there is a qualitative difference between members of Group F having to live in a world in which LGBT couples can marry (the harm caused if Group E's agenda is advanced) and members of the LGBT community being prevented from marrying their partners (the harm caused if Group F's agenda is advanced). The Kaldor–Hicks model cannot account for qualitative differences in these preferences. If Group F is sufficiently larger than Group E, many thin preferences could outweigh the smaller number of thick preferences, implying that taxpayers should be able to deduct amounts donated to Group F but not Group E.[170]

For the reasons discussed above, the Kaldor–Hicks model does not serve as a complete method for determining whether a deduction is warranted in cases where advancement of one organization's purpose always causes negative externalities to opposing groups. Therefore, other principles must be used to analyze the question.

The first preliminary principle—that the government should not subsidize organizations that impinge on individuals' abilities to live as free and equal citizens—does not seem sufficient. In the hunting example presented in Scenario 4, it is unlikely that any of the harms caused would rise to this level. However, allowing groups to deduct amounts to such organizations seems problematic, as it would cause the government to subsidize competing efforts to change society in accord with the viewpoints of particular segments of the population. Importantly, because each organization would receive a subsidy proportionate to the donations it received, the subsidy would always be disparately allocated, even if both "sides" could deduct amounts donated to their corresponding organizations—often allowing those organizations with the largest donor bases to glean larger subsidies

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168. There is certainly a segment of the population which has more than a mild preference. One organization stated that it believes failure to pass the proposition would "undermine[] the value of marriage . . . at a time when [society] should be restoring marriage, not undermining it." *Why Proposition 8*, PROTECT MARRIAGE.COM, http://protectmarriage.com/about/why (last visited Sept. 16, 2010).

169. This is certainly true. One organization whose mission is to "work to achieve equality and secure legal protections" for members of the LGBT community, *About EQCA*, EQUALITY CALIFORNIA, http://www.eqca.org/site/pp.asp?c=kuLRJ9MRKrH&b=4025493 (last visited Sept. 26, 2010), stated that passage of the proposition would "[take] away the fundamental freedom to marry [from LGBT couples] . . . [and] alter the very intent of the [California] Constitution, which is to treat all people equally under the law, *Marriage*, EQUALITY CALIFORNIA, http://www.eqca.org/site/pp.asp?c=kuLRJ9MRKrH&b=4026413 (last visited Sept. 26, 2010).

170. These are dangerous waters into which this Article need not wade. This Article's discussion of preferences as thick and thin is merely to illustrate what cannot even be considered in the Kaldor–Hicks model; it is not meant to definitively characterize preferences.

than those with smaller donor bases (because the more that is donated and deducted, the greater the subsidy).

In light of this, in cases where there is a "plurality of reasonable doctrines"[171]—that is, when there are various non-reconcilable conceptions of "the good," all of which could be believed by reasonable people—it seems important that taxpayers not be able to deduct amounts donated to organizations engaging in efforts to promote any such conceptions.[172] Adherence to this principle would ensure that public funds not be used to disparately promote one viewpoint that, if advanced, would automatically harm those with opposing viewpoints. If this second preliminary principle is used, deductions would not be allowed in either Scenarios 4 or 5. The law accords with this principle to some extent, but does not reach far enough.

Currently, organizations may not receive deductible contributions if they "participate in, or intervene in . . . any political campaign on behalf of . . . any candidate for public office."[173] Furthermore, an organization will not qualify as a tax-exempt organization able to receive deductible contributions if "a substantial part of its activities is attempting to influence legislation by propaganda or otherwise."[174] Thus, under current law, donors could not deduct contributions to any of the organizations in Scenarios 4 and 5. This is in accord with the second preliminary principle and prevents the government from disparately subsidizing one viewpoint over another.

However, further consideration of the two preliminary principles suggests that the law does not go far enough in preventing donors from deducting amounts given to organizations that promote viewpoints on societal issues over which there is reasonable disagreement. Suppose that the facts are the same as Scenario 5, but now Organization F, which supports the proposition that would ban LGBT marriage, is a church.[175] Under current law, donors may deduct amounts

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171. RAWLS, *supra* note 16, at 138. Once again, Rawls's principle is selected because of its appropriateness for analyzing the specific situation at hand and not to suggest that it is an appropriate concept for evaluating society as a whole, or that other versions of the concept he articulates would not be equally appropriate.

172. Rawls believes that when there is this "plurality of reasonable doctrines . . . it is unreasonable or worse to want to use the sanctions of state power to correct, or to punish, those who disagree with us." *Id.*

173. I.R.C. § 501(c)(3) (West 2010); *see also id.* § 170(c)(2)(D).

174. Treas. Reg. § 1.501(c)(3)-1(c)(3)(ii) (as amended in 2008).

175. This is also patterned after the Proposition 8 controversy, where religious organizations, particularly The Church of Jesus Christ of Latter-day Saints, also known as the Mormon Church, were reported to play a large role in passing the Proposition. McKinley & Johnson, *supra* note 167. For an excellent discussion of the involvement of the Mormon Church in the passage of Proposition 8, see generally Galle, *supra* note 167. Mormons donated, helped raise money, and provided "institutional support and dedicated volunteers," to ensure that Proposition 8 would be passed. McKinley & Johnson, *supra* note 167. This discussion does not imply that the church did or did not violate these laws but is simply meant to indicate the extensive role religious organizations play in political issues. Mormon "[l]eaders were . . . acutely conscious of not crossing the line from being a church-based volunteer effort to an actual political organization," in order to avoid running afoul of the tax laws. *Id.* For further analysis on treading the line between acceptable and

contributed to religious organizations (and certain other tax-exempt organizations) that engage in lobbying efforts so long as certain criteria are fulfilled. For instance, the organization's "propaganda" efforts and efforts "to influence legislation" cannot constitute a "substantial part of [its] activities."[176] Further, the organization's "primary objective" may not be one that "may be attained only by legislation or a defeat of proposed legislation."[177]

In this modified example, the church can easily fulfill the second criterion, as a church's primary objective is the promotion of religion (not one which can be attained only through legislative efforts). The church will also fulfill the first criterion so long as lobbying efforts do not become substantial,[178] allowing donors to deduct amounts donated to the church even while the activities regarding the proposition occur. By contrast, under current law, donors will not be able to deduct amounts contributed to Organization E because "a substantial part of its activities is attempting to influence legislation by propaganda or otherwise."[179]

Should donors be able to deduct amounts made to churches that behave in this manner, as they are able to under current law? Under the Kaldor–Hicks model, one would have to weigh the benefits created by the church's activities. First, one would have to account for the benefits created by the church's promotion of religion. Next, one would have to account for the benefits to Group F, if the church's efforts with respect to the proposition were successful. Group F would enjoy a world where members of the LGBT community could not marry, in accordance with their beliefs. On the other side of the equation, one would have to consider the harms caused by the donation being used to advance the support of the proposition. If successful, members of the LGBT community would not be able to marry their partners.

Again, the important point is not that these harms and benefits are difficult to quantify. What is important is that, even if one could quantify and

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unacceptable tax-exempt charity lobbying activities, *see* Galle, *supra* note 167, at 371–75. Importantly, however, the Mormon Church does not deny their extensive involvement. Michael R. Otterson, the managing director of public affairs for the Church of Jesus Christ of Latter-day Saints, reportedly stated: "We've spoken out on other issues, we've spoken out on abortion, we've spoken out on those other kinds of things . . . . But we don't get involved to the degree we did on this." McKinley & Johnson, *supra* note 167.

176.   I.R.C. § 501(h); *see also id.* § 170(c)(2)(D).
177.   Treas. Reg. § 1.501(c)(3)-1(c)(3)(iv).
178.   Section 501(h) provides an "expenditure test" that charitable organizations, other than churches, may elect to use in order to determine if activities are substantial. Treas. Reg. § 1.501(c)(3)-1(c)(3)(ii). Under this test, an organization may attempt to influence legislation so long as associated expenditures do not exceed a specified ceiling amount. *See* I.R.C. § 501(c)(3), (h)(2)(B). The ceiling amount depends on the organization's otherwise exempt income (that is, income used to further the purposes set forth in section 501(c)(3), such as advancing religion, discussed below), and may not exceed $1 million. *Id.* § 4911. Thus, the larger the organization, the more that organization may spend to cause antithetical harms. If an organization does not, or in the case of a church cannot, elect to use the expenditure test provided in section 501(h), the situation becomes uncertain because it is not clear what level of activity will qualify as substantial. *See* Galle, *supra* note 167, at 372 ("There is no clear law on what comprises a 'substantial' amount of lobbying.").
179.   Treas. Reg. § 1.501(c)(3)-1(c)(3)(ii).

balance the benefits and harms, that balance would not be helpful to determine whether donors should be allowed to deduct amounts donated to the church in question; as shown in Scenarios 4 and 5, if the benefitted group is large enough, any harm might be justified.

If, however, one also considered the two suggested preliminary principles, allowing donors to deduct amounts to organizations that engage in lobbying would seem inappropriate regardless of the organization's other purposes. Looking at the first principle and applying it to the modified example, one could argue that preventing an individual from marrying the partner of his or her choosing impinges upon that individual's ability to live a full and meaningful life as a fair and equal member of society. Thus, if one were to agree that the government should not subsidize organizations that impinge on these abilities, then donors should not be able to deduct amounts donated to the church described above. However, one could avoid this somewhat messy inquiry by invoking the second principle, which would alone lead to the conclusion that the deduction is inappropriate as it would result in the government subsidizing the church's view of "the good" (that LGBT couples should not have the right to marry) over other reasonable conceptions of "the good" (that each individual has the right to marry the person of his or her choosing).

Acceptance of this second preliminary principle would, therefore, disallow deductions for organizations whose main purposes generally allow them to receive deductible contributions, such as the church in this modified example, when these organizations also use donations to promote their version of "the good." This seems especially appropriate in this modified example since the competing group (Group E) cannot receive tax-deductible contributions, meaning that the subsidy would be extremely disparate.

This would by no means imply that organizations such as the church described would be flatly prohibited from receiving tax-deductible contributions. Such organizations would, instead, be required to segregate funds used to promote their charitable aims and funds used for lobbying and campaigning. Only funds used for the former aims would be deductible. Donors could specify for which purposes they wished their contributions to be used, thereby allowing donors to choose to what extent their donations would be deductible.[180]

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180. There will be vehement objections to this proposal as religious organizations consistently argue that lobbying activities are inextricably intertwined with the promotion of religion. Churches claim, for instance, to have "a religious duty to intervene in political campaigns and that their religious mission compels them to speak out on behalf of candidates who support the institution's religious mission or to speak against those who take stands inconsistent with those beliefs." Donald B. Tobin, *Political Campaigning by Churches and Charities, Hazardous for 501(c)(3)s, Dangerous for Democracy*, 95 GEO. L.J. 1313, 1316 (2007) (citing Policy Statement, Presbyterian Church (U.S.A.), God Alone is Lord of the Conscience: Policy Statement and Recommendations Regarding Religious Liberty, *reprinted in* 8 J.L. & RELIGION 331, 378 (1990)). One will need to decide whether this argument is sufficient to allow the government to subsidize the profound negative externalities that can be caused by lobbying.

As shown, the Kaldor–Hicks model does not provide a sufficient method to determine whether taxpayers should receive deductions for amounts donated to organizations that, while seeking to promote their version of what is desirable in society, cause harm to opposing groups. If one were to use the preliminary principles suggested, it would support the law's current ban on deducting amounts donated to lobbying organizations. It would, however, also suggest that the ban should be expanded to prohibit donors from deducting amounts donated to organizations with charitable purposes that engage in lobbying efforts.

Application of these principles also suggests that the current practice of allowing taxpayers to deduct contributions to organizations that seek to change public viewpoints through educational efforts is also inappropriate. Consider the following and final scenario:

> *Scenario 6:* Return to the less politically charged Scenario 4, which involved groups having contradictory views regarding hunting. Imagine that instead of directly attempting to influence legislation, Organizations G2 and H2 attempt to change the public's views about hunting by distributing literature and using other information-disseminating media such as websites and e-mails. Organization G2 attempts to convince the public that hunting is undesirable. Organization H2 wishes to convince the public of the importance of hunting.

Organizations, such as those described, often exist as siblings to organizations directly seeking to influence legislation, such as Organizations G and H, described in Scenario 4.[181] Organizations G2 and H2 wish to change the public's opinion on a particular issue—here, hunting—in different directions through education or proselytizing. Presumably, Organizations G2 and H2 wish to create a "multiplier effect," whereby they would convince some individuals of their point of view who would then continue to convince others of this perspective.

If one were to try to assess whether allowing deductions to such organizations is appropriate under subsidy theory, the analysis would not proceed much (if any) differently than the analysis regarding the lobbying activities presented above. Presumably, supporters of Organization G2 would benefit when an individual was convinced of its viewpoint, and supporters of Organization H2 would be correspondingly harmed. The opposite effect would occur if an individual was convinced of Organization H2's viewpoint. Similar problems with the Kaldor–Hicks analysis emerge (for example, if one organization has a support base sufficiently larger than the other, a donation to the larger might be deemed efficient and a donation to the smaller inefficient simply because of the relative size of each group).

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181.   Elizabeth J. Kingsley, *Shared Payroll Considerations in Structuring Cost-Sharing Arrangements*, 19 TAX'N OF EXEMPTS 43, 43 (2007) ("It is common for advocacy organizations to have several different entities in their corporate families—a 501(c)(3), a 501(c)(4), or a 501(c)(6), perhaps a PAC or another Section 527. Each raises and spends funds according to the tax and campaign finance rules applicable to its status, but all share a larger mission of promoting a particular issue position or set of interests.").

Other principles must, therefore, be used. If one believes that the government should not, through the charitable deduction, subsidize the efforts of any particular group to advance its view of "the good" (because it will result in disparate subsidization of opposing viewpoints), then donations made to organizations that seek to advance one view of "the good" should not be deductible, even if the organization does not directly attempt to influence legislation. The law does not accord with this analysis.

Current law allows donors to deduct contributions to many organizations that, like Organizations G2 and H2, seek to change public opinion about issues upon which there is reasonable disagreement. For instance, the mission statement of The National Rifle Association Foundation, Inc., a sister-organization to The National Rifle Association (NRA), self-described as being "widely recognized . . . as a major political force and as America's foremost defender of Second Amendment rights,"[182] states:

> Established in 1990, The NRA Foundation, Inc. ("NRA Foundation") is a 501(c)(3) tax-exempt organization that raises tax-deductible contributions in support of a wide range of firearm-related public interest activities of the National Rifle Association of America and other organizations that defend and foster the Second Amendment rights of all law-abiding Americans. These activities are designed to promote firearms and hunting safety, to enhance marksmanship skills of those participating in the shooting sports, and to educate the general public about firearms in their historic, technological, and artistic context. Funds granted by The NRA Foundation benefit a variety of constituencies throughout the United States including children, youth, women, individuals with physical disabilities, gun collectors, law enforcement officers, hunters, and competitive shooters.[183]

The NRA characterized the establishment of its Foundation as a "dramatic move" to ensure future financing in order to "provide[] a means to raise millions of dollars to fund gun safety and educational projects of benefit to the general public. Contributions to the Foundation are tax deductible and benefit a variety of American constituencies."[184]

On the other side of the spectrum, the Committee to Abolish Sport Hunting's mission statement reads:

> The mission of C.A.S.H.—Committee to Abolish Sport Hunting—is to accomplish what its name says in the shortest possible time. Understanding that abolishing hunting entails a process, a series of steps taken and not a single action that would effect our goal overnight, a time frame cannot be established. We hope for building a succession of wins, and if not wins immediately then at least a

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182. *A Brief History of the NRA*, NRA, http://www.nra.org/Aboutus.aspx (last visited Aug. 31, 2010).

183. *About*, NRA FOUND., http://www.nrafoundation.org/about/ (last visited Aug. 31, 2010).

184. *A Brief History of the NRA*, *supra* note 182.

succession of stirrings of consciousness. We hope to encourage those who are still silent to speak out, awakening community after community about the heavy hand of state and federal wildlife management agencies. We hope to alter whatever belief still exists that sport hunters are conservationists and champions of the environment to a realization that they are destroyers of wildlife and ecosystems in the narrow and broad sense. Where the natural feeling for wildlife doesn't exist, we strive to engender among citizens outrage that their own rights are violated by legal hunting and that their quality-of-life [is] diminished.[185]

C.A.S.H. is also a 501(c)(3) organization whose donors may deduct amounts contributed to it.[186]

To further illustrate, the Pennsylvania Pro-Life Federation Educational Fund is "an outgrowth of the Pennsylvania Pro-Life Federation, Inc.,"[187] an organization which "[t]hrough legislation, political action, education and other legal means, . . . proclaim[s] the truth about abortion, infanticide, and euthanasia."[188] The Fund is a:

> tax-exempt organization . . . under section 501(c)(3) . . . [that] has undertaken projects to educate Pennsylvanians about the personhood of children in the womb; the truth about what abortion is and what it does to mothers and their preborn children; the importance of teaching teens to live a chaste life and avoid unwanted pregnancy; and the availability of viable, life-affirming alternatives to abortion, such as adoption and assisted parenting.[189]

Advocating the opposite perspective, NARAL Pro-Choice America Foundation, an outgrowth of NARAL Pro-Choice America, which is committed to "protect[ing] the right to choose,"[190] is a 501(c)(3) organization able to receive tax-deductible contributions which "support[s] and protect[s], as a fundamental right and value, a woman's freedom to make personal decisions regarding the full range of reproductive choices through education, training, organizing, legal action, and public policy."[191]

Current law allows taxpayers to deduct amounts contributed to organizations such as those discussed, often by qualifying these entities as

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185. *C.A.S.H. Mission Statement*, COMMITTEE TO ABOLISH SPORT HUNTING, http://www.all-creatures.org/cash/about.html (last visited Aug. 31, 2010).

186. *Id.*

187. *Who We Are and What We Do*, PA. PRO-LIFE FED'N, http://www.paprolife.org/about_us.html (last visited Aug. 31, 2010); *see also id.* (noting that the Pennsylvania Pro-Life Federation Educational Fund is a tax-exempt organization under section 501(c)(3)).

188. *Id.*

189. *Id.*

190. *About Us*, NARAL PRO-CHOICE AM., http://www.prochoiceamerica.org/about-us/ (last visited Aug. 31, 2010).

191. *Supporting NARAL Pro-Choice America Foundation*, NARAL PRO-CHOICE AM., http://www.naral.org/donate/planned-giving/c3_planned_giving.html (last visited Sept. 26, 2010).

educational or charitable organizations. Recall that donors may deduct amounts contributed to organizations organized and operated for either of these purposes under section 170(c).

An organization is considered educational if it performs either of two functions: "(a) The instruction or training of the individual for the purpose of improving or developing his capabilities; or (b) The instruction of the public on subjects useful to the individual and beneficial to the community."[192]

An organization may qualify as an educational organization and advocate its viewpoints so long as it does so in a manner that "presents a sufficiently full and fair exposition of the pertinent facts as to permit an individual or the public to form an independent opinion or conclusion."[193] An organization is not "educational" (and donors may not deduct contributions) if "its principal function is the mere presentation of unsupported opinion."[194] A methodology test has been developed to determine when an organization has not provided a full and fair exposition of the facts, such that the organization may not qualify to receive deductible contributions. The methodology test consists of four factors, the presence of which indicates that the expression is not a full and fair exposition:

> 1) The presentation of viewpoints or positions unsupported by facts is a significant portion of the organization's communications; 2) The facts that purport to support the viewpoints or positions are distorted; 3) The organization's presentations make substantial use of inflammatory and disparaging terms and express conclusions more on the basis of strong emotional feelings than of objective evaluations; 4) The approach used in the organization's presentations is not aimed at developing an understanding on the part of the intended audience or readership because it does not consider their background or training in the subject matter. [195]

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192. Treas. Reg. § 1.501(c)(3)-1(d)(3)(i) (as amended in 2008) (setting forth criteria for organizations to qualify for tax-exempt status as educational organizations under section 501(c)(3)). These requirements also determine whether taxpayers can deduct amounts paid to these organizations. *See, e.g.*, INTERNAL REVENUE SERV., PUB. 557, TAX-EXEMPT STATUS FOR YOUR ORGANIZATION 20 (Oct. 2010), *available at* http://www.irs.gov/pub/irs-pdf/p557.pdf ("Contributions to domestic organizations [qualifying under section 501(c)(3)], except organizations testing for public safety, are deductible as charitable contributions on the donor's federal income tax return."); *see also* Big Mama Rag, Inc. v. United States, 631 F.2d 1030, 1033 n.2 (D.C. Cir. 1980) ("Tax-exempt status is desirable for two reasons: the profits of the exempt corporations are not subject to federal income tax, . . . and corporations to the organization are tax deductible.") (citations omitted).

193. Treas. Reg. § 1.501(c)(3)-1(d)(3)(i).

194. *Id.*

195. Rev. Proc. 86-43, 1986-2 C.B. 729. The test was first set forth in *National Alliance v. United States*, 710 F.2d 868, 874 (D.C. Cir. 1983), and subsequently published in Rev. Proc. 86-43, 1986-2 C.B. 729. Although not binding as administrative "rules," Est. of Lang v. Comm'r, 64 T.C. 404, 406–07 & n.4 (1975), Revenue Procedures constitute official statements of IRS procedure. Rev. Proc. 89-14, 1989-1 C.B. 814. Further, courts

Thus, so long as organizations such as those described above promote their viewpoints within these limitations, taxpayers may deduct amounts donated to them.

Organizations attempting to change public opinion may also receive tax-deductible contributions by qualifying as "charitable" organizations. Relevant regulations state that:

> The fact that an organization, in carrying out its primary purpose, advocates social or civic changes or presents opinion on controversial issues with the intention of molding public opinion or creating public sentiment to an acceptance of its views does not preclude such organization from qualifying under section 501(c)(3) [to receive tax-deductible contributions] so long as it is not an action organization . . . .[196]

An organization may be considered an action organization (not able to receive deductible contributions) if it "fails" any of three tests. First, an organization is an action organization "if a substantial part of its activities is attempting to influence legislation by propaganda or otherwise."[197] Second, an organization is an action organization if it "participates or intervenes, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office."[198] Third, an organization is an action organization:

> if it has the following two characteristics: (a) Its main or primary objective or objectives (as distinguished from its incidental or secondary objectives) may be attained only by legislation or a defeat of proposed legislation; and (b) it advocates, or campaigns for, the attainment of such main or primary objective or objectives . . . .[199]

So long as organizations such as those described seek to change public viewpoints without seeking to influence legislation, they may also be able to receive deductible contributions by qualifying as charitable organizations.

Consideration of the second principle suggests that donors should not be able to deduct contributions made to those organizations that seek to promote particular viewpoints on issues upon which there is reasonable disagreement, regardless of whether these tests are fulfilled. Allowing the deduction runs afoul of the notion that the government should not subsidize one version of "the good" over others and results in the disparate subsidization of certain viewpoints over others, often in favor of organizations with the largest support bases. This suggests another place in which the current law should be reformed.

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have tended to follow the methodology test, and the IRS has continued to use it. *See, e.g.*, Nationalist Movement v. Comm'r, 37 F.3d 216, 218 n.2 (5th Cir. 1994).

    196.   Treas. Reg. § 1.501(c)(3)-1(d)(2). The Internal Revenue Code provides that even an organization with a qualifying purpose (such as a charitable organization), I.R.C. §§ 501(c)(3), 170(c)(2)(B), cannot receive deductible contributions if it is disqualified from tax-exempt status "by reason of attempting to influence legislation," *Id.* § 170(c)(2)(D). The regulations, in turn, explain when this disqualification will occur.

    197.   Treas. Reg. § 1.501(c)(3)-1(c)(3)(ii).
    198.   Treas. Reg. § 1.501(c)(3)-1(c)(3)(iii).
    199.   Treas. Reg. § 1.501(c)(3)-1(c)(3)(iv).

CONCLUSION

Despite its longevity, the rationale for the charitable deduction is the subject of continuing debate. Subsidy theory is one of the most often utilized theories for determining circumstances in which a deduction is needed to encourage giving that would not occur in its absence.

But subsidy theory, along with other scholarly theories, has failed to recognize that, while charitable organizations may very well produce positive externalities, they may also cause negative externalities of various types and magnitudes. This Article recognizes this important fact and illustrates how an application of the Kaldor–Hicks model to transfers creating negative externalities yields inappropriate and unhelpful results for analyzing whether a charitable deduction is warranted.

Specifically, when negative externalities are limited to those assumed by subsidy theorists—when the only harm caused by a transfer is universal subsidization harm and slight psychic harms—it is generally easy for donations to be deemed efficient under the Kaldor–Hicks model. However, as negative externalities become severe, it is clear that the Kaldor–Hicks model cannot serve as a complete method for separating transfers that should and should not receive a charitable deduction.

In order to fill this gap, other factors must be considered. This Article offers two preliminary principles to evaluate situations where charities create these more serious negative externalities. These principles are offered as a starting point for discussion and are by no means meant to provide an exhaustive answer to the difficult problem of subsidy theory, and other theories, failing to adequately account for negative externalities.

First, after recognizing that the Kaldor–Hicks model might allow taxpayers to deduct amounts donated to organizations that cause extremely profound harms, such as harms caused by exclusion policies, this Article suggests that there should be a limit to the types of harm that the government can subsidize. Thus, the first principle suggests that the government should not subsidize organizations that impinge on an individual's ability to live a full and meaningful life as a fair and equal member of society. Taxpayers should not be able to deduct amounts donated to organizations that curtail one's ability to so live. This suggests that the current practice of allowing taxpayers to deduct amounts donated to organizations with certain exclusion policies is inappropriate.

Second, this Article illustrates that the Kaldor–Hicks model cannot serve as a sufficient method for determining whether taxpayers should be able to deduct amounts donated to organizations that seek to promote opposing viewpoints on issues upon which there is reasonable disagreement. The second principle offered to fill this gap is rooted in the belief that the government should not support one reasonable conception of "the good" over any other.[200] If accepted, the government should not subsidize (through a charitable deduction) organizations advancing any particular viewpoint. Allowing taxpayers to deduct amounts contributed to these

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200.   RAWLS, *supra* note 16, at 138.

organizations would result in disparate subsidization of different "sides" of societal debates, often favoring larger groups.

The law currently does not allow donors to deduct amounts donated to lobbying organizations that seek to influence legislation. This accords with the second principle. The second principle also suggests, however, that the ban should be expanded. Current law inappropriately allows deductions for donations made to certain 501(c)(3) organizations that engage in lobbying efforts, so long as their lobbying is sufficiently limited. This runs afoul of the principle that the government should not subsidize efforts to promote any version of "the good." These organizations should segregate funds, and donors should only be able to deduct amounts used to further charitable purposes. The second principle also suggests that the law inappropriately allows donors to deduct amounts contributed to organizations, often siblings of lobbying groups, which do not directly seek to influence legislation but seek to educate or proselytize their viewpoints.

Subsidy theory provides a useful starting point for limiting the charitable deduction. However, along with other theories analyzing the deduction, it has routinely failed to consider cases where donations are made to organizations which, in addition to creating positive externalities, also create negative externalities. The suggested principles presented act as a starting point to fill this gap and will, hopefully, create further discourse about whether and to what extent taxpayers should be able to deduct amounts donated to "charities" that cause harm.