

AMERICAN NONPROFIT LAW IN COMPARATIVE PERSPECTIVE

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I. INTRODUCTION

The third sector deserves a second look.¹ The importance of nonprofits is intensifying around the globe. Nonprofit organizations are essential to the effective management of society's goals and priorities, both in the United States and abroad. Catastrophes and challenges unresolved by governments and for-profit businesses increasingly demand the contributions of charitable institutions.² The third sector has come into its own.

Despite the prominence of many American nonprofit institutions, the growing recognition of the field of nonprofit law as a distinct area of study and practice is a relatively recent trend.³ In 2006, a proposal was made to the American Association of Law Schools to create a new section on Nonprofit and Philanthropy Law.⁴ In 2007, a blog for law professors specializing in nonprofit law was established.⁵ In 2009, the American College of Trusts and Estates Counsel sponsored a symposium entitled "The Law of Philanthropy in the 21st Century."⁶ The momentum gathering behind the movement to recognize and analyze nonprofit law as a discrete area of legal study offers a rare opportunity to improve that field by encouraging an international perspective. As part of its growing commitment to examine and improve the state of nonprofit law in America, legal scholarship should embrace a comparative law approach.⁷

1. The first sector is government; the second sector is business; the third sector is philanthropy. See ROBERT L. PAYTON & MICHAEL P. MOODY, UNDERSTANDING PHILANTHROPY: ITS MEANING AND MISSION 46–52 (2008). The "third sector" is also defined as "the voluntary and community sector, the non-profit sector, the social enterprise sector and civil society." Stephen P. Osborne, *Key Issues for the Third Sector in Europe*, in THE THIRD SECTOR IN EUROPE: PROSPECTS AND CHALLENGES 3, 6 n.1 (Stephen P. Osborne ed., 2008).

2. Nonprofits played a significant role in responding to the Haitian earthquake. See Stephanie Strom, *Haitian Quake Brings More Money and Scrutiny to a Charity*, N.Y. TIMES, Feb. 5, 2010, at A17. The American Red Cross received over \$100 million in pledges to respond to the crisis. Stephanie Strom, *A Deluge of Donations via Text Messages*, N.Y. TIMES, Jan. 18, 2010, at A1.

3. See Elizabeth A. Moody, *Revising the Model Nonprofit Corporation Act: Plus Ça Change, Plus C'est la Meme Chose*, 41 GA. L. REV. 1335, 1337 (2005) ("Until recently, nobody thought much about laws pertaining to nonprofit corporations, and for that matter, no one thought much about nonprofit corporations.").

4. See Letter from David A. Brennen, Ellison C. Palmer Professor of Tax Law, to the Committee on Sections for the Association of American Law Schools (Feb. 6, 2006), available at http://www.philanthropy.iupui.edu/about/aals/aals_petition.html.

5. See generally Nonprofit Law Prof Blog, <http://lawprofessors.typepad.com/nonprofit/2007/week48/index.html> (last visited Jan. 21, 2011).

6. The symposium was co-sponsored and hosted by the Chicago-Kent School of Law; the program can be found at http://www.cklawreview.com/wp-content/uploads/PROGRAMFINAL_COLOR.pdf (last visited Jan. 21, 2011).

7. Many scholars in other disciplines and countries do embrace an international approach to the

Emphasizing a comparative approach to nonprofit law is essential for a thorough conception of the field.⁸ The need for an understanding of international law and comparative perspectives has long been recognized,⁹ but its importance is growing exponentially.¹⁰ The world's economies are increasingly intertwined, with the growth of travel and worldwide communication capabilities fostering cross-national interaction.¹¹ We are no longer "largely independent societies," but have instead evolved into a "multicultural, interdependent, interconnected collective."¹² Globalization has impacted American courts and nearly every sector of our society.¹³

Comparative law approaches also offer benefits for law students.¹⁴ A great variety of legal systems and cultures exist throughout society, which reveal several different ways to handle the same issues.¹⁵ Analyzing the

study of the third sector. The International Society for Third-Sector Research, where this Article was presented in the summer of 2010, provides one avenue for such collaboration. *See* INT'L SOC'Y FOR THIRD-SECTOR RESEARCH, <http://www.istr.org> (last visited Jan. 21, 2011). Significant amounts of international research on nonprofits also have been accomplished through the Johns Hopkins Center for Civil Society Studies Project; *see* CTR. FOR CIVIL SOC'Y STUDIES, <http://www.ccss.jhu.edu/> (last visited Jan. 21, 2011).

8. Also essential to a thorough understanding of the third sector is an interdisciplinary approach. Law, although a key element of the structure of nonprofits, has no monopoly on the study of nonprofits. A thorough understanding of charitable organizations requires contributions by scholars of government, public policy, and many social science disciplines. This Article relies upon such an interdisciplinary group of contributors.

9. *See, e.g.*, JAMES KENT, 1 COMMENTARIES ON AMERICAN LAW 20 (2d ed. 1832) ("I think I cannot be mistaken in considering the elementary learning of the law of nations, as not only an essential part of the education of an American lawyer, but as proper to be academically taught."); *see also* THEODORE D. WOOLSEY, INTRODUCTION TO THE STUDY OF INTERNATIONAL LAW 355 (4th ed. 1874) ("[E]very educated person ought to become acquainted with international law because he is a responsible member of the body politic and . . . because the executive if not controlled will be tempted to assume the province of international law for us.").

10. On the importance of the study of international law generally, *see* Myres S. McDougal, *The Impact of International Law Upon National Law: A Policy-Oriented Perspective*, 4 S.D. L. REV. 25, 35–36 (1959).

11. John A. Barrett, Jr., *International Legal Education in the United States: Being Educated for Domestic Practice While Living in a Global Society*, 12 AM. U. J. INT'L L. & POL'Y 975, 981–82 (1997).

12. *Id.* at 981.

13. *See* Javier H. Rubinstein, *International Law's New Importance in the U.S.*, NAT'L L.J., Sept. 15, 2003, at 16 (noting the increasing frequency with which the U.S. Supreme Court has begun to refer to international law in reaching its decisions).

14. Barrett, Jr., *supra* note 11, at 983–85. One "important reason to study comparative law is the skills it provides." *Id.* at 984. Any lawyer practicing in the 21st century can expect to encounter international legal issues at least occasionally throughout a career. *See* Jorge A. Ramirez, *International Law Impacts Texas and the Texas Tech School of Law Responds*, 35 TEX. TECH. L. REV. 265, 266 (2004) ("Legal institutions across the country, including the United States Supreme Court, are becoming progressively more aware of the importance of global issues and likewise acknowledge the need to make certain that future lawyers understand where, when, and how domestic law and international law merge and diverge.").

15. Barrett, Jr., *supra* note 11, at 985.

diversity of approaches may foster creative skills and contribute to a greater commitment to understanding the *problems*—the issues critical to a client—rather than the nuances of a “particular legal regime.”¹⁶

The purpose of this Article is to examine nonprofit organizations from such an international perspective, and to cross-pollinate the fields of third-sector research and international law. A law review article can provide only a broad introduction to this genre, but is an important step in the integration of these fields. My hope is that this Article will provide a glimpse for these groups into each others’ worlds such that (1) scholars and students of international law might recognize the important role of the third sector, and (2) scholars and students of nonprofit studies might recognize the contribution of a comparative legal approach.¹⁷

This Article is novel in its breadth, and intentionally so. Most comparative law articles choose depth over breadth, focusing on the details of how one or two countries’ approaches to a legal issue are distinguishable from the American system.¹⁸ Although this technique is useful, it is only through the cumulative impact of many different approaches that true idiosyncrasies become obvious. This Article therefore provides a window into not one, but nine alternative international approaches to nonprofit law. It is against this relief that American distinctiveness glares.

This Article begins with an introduction to the colorful variety of approaches to nonprofit regulation that the international community affords, analyzing the nonprofit sector in several countries in Europe (France, Germany, Italy, and Sweden) and in Asia (India, Bangladesh, Pakistan, Nepal, and Sri Lanka). The Article next explains the basics of American nonprofit law, first discussing state regulation, and then federal regulation. The American approach is then contrasted with the systems of nonprofit regulation in other countries, and two distinctive themes of American law emerge. First, American nonprofit law has a different *primary relational focus*: it regulates the relationship between the nonprofit and its donors and leaders, rather than the relationship between the nonprofit and the government. Second, American nonprofit law is unusually *tax-centric* in its regulatory scheme: the Treasury is a

16. *Id.* at 984–85.

17. It is my hope that this Article might be useful to law students studying international law, perhaps through a study abroad program. While international programs often emphasize the first two sectors—government and business—very little attention is given to the third.

18. *See, e.g.,* Yolanda Demianczuk, *Charity Regulation in the Russian Federation*, 35 COLUM. J. TRANSNAT’L L. 477 (1997).

questionable locus of regulation for nonprofits, and most other countries use tax only as a supplemental, rather than central, regulatory force. The Article concludes with a call for greater attention to international and interdisciplinary approaches to the third sector.

II. EUROPEAN AND ASIAN NONPROFIT LAW

A. *The Third Sector in Europe*

Nonprofit organizations in Europe offer an informative foil to the American approach. Although some regions share similar outlooks on the role of the third sector, each country—with its unique history and government—contributes to notable variety throughout Europe.¹⁹ France, Italy, Germany, and Sweden share a commitment to addressing the challenges of the third sector, but they differ as to their regulatory structures.²⁰ The following introduction to the world of nonprofits in Europe demonstrates how several countries monitor the dynamic between the voluntary sector and governmental control.

1. *France*

In France, the perception of the role of philanthropy and the third sector, like many of its European neighbors, is heavily influenced by the history of its government.²¹ Following the French Revolution, the right to form associations was strictly limited in an attempt to ensure that anti-democratic guilds would not interfere with individual liberties.²² For some time, economic and professional associations (as well as clubs, academies, and women's societies) were banned.²³ Modern movements (following the French labor and socialist movements) embraced a broader role for associations.²⁴ There remains a “tradition of French associationism”²⁵—a history of “cooperative socialism so closely bound up with the democratic

19. See generally Janelle A. Kerlin, *Social Enterprise in the United States and Europe: Understanding and Learning from the Differences*, 17 *VOLUNTAS* 247 (2006) (discussing the broad differences among the American and European nonprofit sector).

20. For a thorough discussion of nonprofit endeavors in many countries throughout Europe, see generally *THE THIRD SECTOR IN EUROPE* (Adalbert Evers & Jean-Louis Laville eds., 2004).

21. On the French third sector generally, see Philippe Chanial & Jean-Louis Laville, *French Civil Society Experiences: Attempts to Bridge the Gap Between Political and Economic Dimensions*, in *THE THIRD SECTOR IN EUROPE*, *supra* note 20, at 83–99.

22. *Id.* at 84.

23. *Id.*

24. *Id.* at 85–88.

25. *Id.* at 83.

republican movement²⁶—that continues to influence French notions of how citizens should support each other and themselves through a commitment to solidarity.

Nonprofit associations were recognized in France by the Act of 1901.²⁷ Most French nonprofit organizations belong to one of three categories: cooperatives, mutuals, and associations.²⁸ Cooperatives are organizations that provide resources in areas where for-profit industries are relatively weak.²⁹ They are part of the market economy, distinctively competitive, and regulated by the state.³⁰ Cooperatives tend to focus their mission on specialized concerns and often prioritize long-term sustainability of the organization over furthering dramatic political change.³¹ Mutuals are organizations established by individuals with common concerns and risks.³² Mutuals often address issues of loss of health, life, or work, and tend to be supported by individuals who share a profession, location, or other commonality that inspires solidarity within the group.³³ For-profit insurance companies are sometimes direct competitors with mutuals, and may interfere with their successful operation.³⁴ Associations are nonprofit organizations designed to provide social services. Because of the relatively high degree of governmental regulation—and the reliance upon the government rather than individual donations for financial support—associations tend to be very centralized, with a few strong united national organizations, rather than many smaller entities.³⁵

French philanthropy embraces the notion of solidarity and supports self-organization and association as a mechanism for assuaging the injuries of the market economy.³⁶ Association through voluntary involvement in nonprofit organizations is an opportunity to express a

26. *Id.* at 98 n.1.

27. Chaniel & Laville, *supra* note 21, at 90.

28. *Id.*

29. *Id.*

30. *Id.*

31. *Id.*

32. *Id.*

33. Chaniel & Laville, *supra* note 21, at 90–91.

34. *Id.*

35. *Id.* at 91. France introduced the “societe co-operative d’interet collectif” (cooperative society of collective interest) in 2001. Janelle A. Kerlin, *Social Enterprise in the United States and Abroad: Learning from Our Differences*, in RESEARCH ON SOCIAL ENTREPRENEURSHIP, ARNOVA OCCASIONAL PAPER SERIES NO. 1.3, at 8, 16–17 (Rachel Mosher-Williams ed., 2006), available at http://www.nationalcne.org/index.cfm?fuseaction=feature.display&feature_id=141&CFID=737&CFTOKEN=90849585 (noting that in the French system “[p]rofits can be made but nonprofit status prohibits the accumulation of surpluses beyond those needed for day-to-day use”).

36. See Chaniel & Laville, *supra* note 21, at 83–84.

commitment to democratic ideals and to moderate the “threat from the assertiveness of the market” with deliberate social intervention.³⁷ Nonprofit organizations contribute to “democratization of the economy” by ensuring that social goals aside from economic growth are not completely overshadowed by the “monetarization and commercialization of everyday life” that the markets alone would engender.³⁸ The market economy functions as the initial distribution channel of the exchange of goods and services; the third sector integrates notions of redistribution or reciprocity, resulting in a more just allocation of resources.³⁹ The French third sector, therefore, is acutely aware of its relationship with the second sector (private, for-profit industry) as well as the first (the government).

French tax law allows “special treatment” to nonprofit organizations⁴⁰ and provides for certain benefits to those organizations that serve the public interest.⁴¹ In addition to those benefits, French tax law permits partial income tax exemptions to those who make monetary contributions to charitable organizations.⁴²

The role of the voluntary sector in France today is as strong as ever. The movement toward achieving “economic action through solidarity” has supported the growth of associations in recent years.⁴³ The Act of 1901 establishing nonprofit associations was well-celebrated upon its 100th anniversary, and recent governmental actions (such as the creation of a state secretary for the civil and solidarity-based economy) demonstrate the growing recognition of the importance of the third sector’s role.⁴⁴

37. *Id.* Nonprofit organizations in France include those formed for political and patriotic purposes. Nina J. Crimm, *Democratization, Global Grant-Making, and the Internal Revenue Code Lobbying Restrictions*, 79 TUL. L. REV. 587, 664 n.327 (2005) (noting that such “associations with well-defined declared aims can lobby for legislation with government officials and parliament” (quoting EDITH ARCHAMBAULT, *THE NONPROFIT SECTOR IN FRANCE* 68, 77–78 (1997))).

38. *See* Chaniel & Laville, *supra* note 21, at 97.

39. *Id.* at 93.

40. EDITH ARCHAMBAULT, *THE NONPROFIT SECTOR IN FRANCE* 66–69 (1997). A nonprofit organization will not have to pay a corporation tax (the common marginal rate is 37% or 42%) on its income as long as the organization meets the qualifications. *Id.*; *see also* CODE GÉNÉRAL DES IMPÔTS art. 206-1 (Fr.).

41. ARCHAMBAULT, *supra* note 40, at 66.

42. *Id.* at 66, 69–72. Deductions are a relatively recent addition to French tax law. *Id.* at 69. Deductions are only allowed for cash contributions. *Id.* at 72. Thus, French tax law differs from American tax law that allows for property contributions to be deductible.

43. *See* Chaniel & Laville, *supra* note 21, at 97.

44. *Id.* at 96–97.

2. Germany

The German approach to the third sector is distinctive.⁴⁵ The range of third-sector organizations is “extremely varied,” and includes small local nonprofits, large national or international charities,⁴⁶ organizations that provide tangible services, organizations that contribute to the shaping of public opinion, organizations that focus on income redistribution and charitable endeavors, and organizations that focus on “social economy,” like cooperatives and mutuals.⁴⁷

Nonprofits play a significant role in German society. In 1995, the German nonprofit sector comprised 4% of Germany’s GDP.⁴⁸ Voluntary welfare organizations employ about 3% of all workers.⁴⁹ Volunteers in these associations exceed 2.5 million, nearly triple the number of paid employees.⁵⁰ That said, Germany relies on a steady source of volunteers much less than many of its European neighbors, in part because today’s youth volunteer less frequently than previous generations.⁵¹

While all German entities are required to pay corporate income tax, these entities “can be exempted when they pursue qualified philanthropic purposes enumerated in the AO (Arts. 52–54 *Abgabenordnung*).”⁵² German tax law allows individual and corporate income tax deductions for contributions “to certain public benefit organizations.”⁵³

45. See generally Ingo Bode & Adalbert Evers, *From Institutional Fixation to Entrepreneurial Mobility? The German Third Sector and Its Contemporary Challenges*, in *THE THIRD SECTOR IN EUROPE*, *supra* note 20, at 101–21.

46. There are presently six nationally organized nonprofit welfare federations. See *id.* at 107.

47. *Id.* at 102.

48. Annette Zimmer, *Corporatism Revisited—The Legacy of History and the German Nonprofit Sector*, in *THIRD SECTOR POLICY AT THE CROSSROADS: AN INTERNATIONAL NONPROFIT ANALYSIS* 114, 115 (Helmut K. Anheier & Jeremy Kendall eds., 2001). In 1995, the German nonprofit sector had \$84 billion total operating expenditures. *Id.*

49. Bode & Evers, *supra* note 45, at 108. These organizations “see themselves as struggling for a certain economic organization of society, by creating reformatory concepts of a ‘social economy’ beyond market enterprises and the logic of bureaucratic redistribution.” *Id.* at 102; see also Zimmer, *supra* note 48, at 115 (finding that the employment in the nonprofit sector comprises 5% of the total labor force).

50. Bode & Evers, *supra* note 45, at 108. As of 1996, there were roughly 1 million paid employees of nonprofits in Germany. *Id.*

51. *Id.* at 113.

52. COUNCIL ON FOUNDATIONS, U.S. INTERNATIONAL GRANTMAKING—GERMANY 8 (Aug. 2009), available at <http://www.usig.org/ICNL/countryinfo/PDF/Germany.pdf>.

53. *Id.* at 8–9. Deductions do have a ceiling limit:

For contributions made by individuals or corporations, a tax deduction of up to 20 percent is possible on yearly taxable income (or 0.4 percent of the sum of the turnover, wages, and salaries) if the recipient organization pursues qualifying purposes (Article 10b EStG and Article 9 (1) No.2 of KStG). Donations exceeding the deductible limit may be carried forward to subsequent fiscal years.

The German notion of nonprofits is perhaps more appropriately conceived as an “intermediary sphere” than a “third sector.”⁵⁴ Rather than operating independently of the state and market, modern nonprofits share commonalities with both business and government sectors, and can even operate as “hybrid” organizations.⁵⁵ Germany’s nonprofit sector is dominated by nonprofits engaged in the fields of healthcare and social services.⁵⁶ These organizations are “to a remarkable extent . . . integrated into the system of the German welfare state.”⁵⁷ In some instances, the law requires governmental support of the nonprofit sector.⁵⁸ German nonprofits are characterized by their need to compete and entrepreneurial outlook, like for-profit business, but also by their commitment to public good and access to resources of the state, like government.⁵⁹

Unlike many of its European neighbors, Germany’s cooperatives no longer occupy a primary role in the German nonprofit sector. The market sector has largely subsumed cooperative nonprofits, which primarily operated to support the common needs of workers.⁶⁰ With economic and welfare reform considered to be a responsibility for the state, the social and moral underpinnings of the cooperatives faded, leaving primarily business concerns.⁶¹

The most effective German nonprofits are strong in their entrepreneurial stance and willing to adapt to changes in environment and economics.⁶² Many engage in specific strategies to promote the organization’s success, including linking different types of entrepreneurship, encouraging solidarity and publicity, and “normalizing”

In addition, an individual donor can deduct up to €1,000,000 for a donation to the endowment of a foundation with qualifying purposes. The deduction can be taken in the year of donation and/or divided over the following nine years.

Id.

54. Bode & Evers, *supra* note 45, at 101.

55. *Id.*

56. Zimmer, *supra* note 48, at 115. Sixty-one percent of the operating expenditures for the nonprofit sector are comprised of those nonprofits engaged in healthcare and social services. *Id.* These organizations typically receive revenues in the form of reimbursements from insurance funds, as well as governmental subsidies. *Id.*

57. *Id.* at 114, 116.

58. *See id.* at 114 (observing that “[e]ven local governments are obliged to subsidize nonprofits organizations active in healthcare or social service activities in Germany”); *see also* Bode & Evers, *supra* note 45, at 101 (noting “the high financial commitment of the state and a long-standing public-private partnership”).

59. Bode & Evers, *supra* note 45, at 101.

60. *Id.* at 106. Cooperative nonprofits are identified by the terms “Gemeinwirtschaft” or “Genossenschaften.” *Id.*

61. *Id.* at 106. Mutual health insurance organizations, however, still persist. *Id.* at 107.

62. *Id.* at 114.

the provision of welfare services from nonprofit groups.⁶³ The future of the third sector in Germany is promising, as long as nonprofits remain attuned to issues relating to the service culture, how service tasks are structured, the role of “civic and moral commitment,” and interaction with public authorities.⁶⁴

3. *Italy*

Although Italian philanthropy faced many challenges throughout its history, today the third sector is of growing importance in Italian society.⁶⁵ At the beginning of the new millennium, Italy was home to almost a quarter-million nonprofit organizations.⁶⁶ The vast majority of Italian nonprofits depend on volunteers; 3.2 million people count themselves as volunteers for these nonprofits, and roughly 630,000 are paid workers.⁶⁷ Only 15.2% of Italian nonprofits have any paid employees; the role of the volunteer is paramount.⁶⁸

Italian nonprofits may exist in a variety of forms, but most (over 91%) operate as associations, and the majority of these associations are not legally recognized entities.⁶⁹ They address a variety of causes, the most common of which are social services, social welfare, health, education, research, culture, sports, and recreation.⁷⁰ Many Italian nonprofits are social cooperatives, and Italian law recognizes two varieties of these cooperatives.⁷¹ The first type consists of cooperatives that deliver social, health and educational services.⁷² The second type produces goods or provides non-social services, in order to offer employment opportunities for “disadvantaged workers.”⁷³ This second type of cooperative must

63. *Id.* at 115.

64. *Id.* at 116–18.

65. See generally Carlo Borzaga, *From Suffocation to Re-emergence: The Evolution of the Italian Third Sector*, in *THE THIRD SECTOR IN EUROPE*, *supra* note 20, at 45–62.

66. *Id.* at 59. The data discussed in this section comes from a census of Italian nonprofits conducted in 2000 by the National Statistics Institute, and reflects statistics in 1999. *Id.* There were 221,412 nonprofits included in the data in 1999.

67. *Id.*

68. *Id.*

69. *Id.*

70. *Id.*

71. Borzaga, *supra* note 65, at 55; see also Antonio Thomas, *The Rise of Social Cooperatives in Italy*, 15 *VOLUNTAS* 243, 243–64 (2004) (providing an overview of social cooperatives in Italy).

72. Borzaga, *supra* note 65, at 55.

73. *Id.*

employ at least 30% “disadvantaged workers,” and may be exempt from certain governmental payments related to their employment.⁷⁴

Italian nonprofit organizational form does not center upon the nonprofit distribution constraint like American law does.⁷⁵ The Italian third sector is characterized by the less formal and more flexible association and cooperative forms.⁷⁶ Scholars have theorized that involvement and participation by nonprofit stakeholders and democratic management of nonprofits constitute sufficient mechanisms for creating accountable and well-functioning charities in Europe, and that the American distribution constraint model is not the only solution.⁷⁷

Although the history of philanthropy in Italy is long and complex, it is in many ways a young system, or a recently reborn one. The vast majority of nonprofits in Italy are new: as of 2000, over 55% of existing nonprofits were less than ten years old, and less than 22% had operated for more than twenty years.⁷⁸

The first Italian law relating to nonprofits was the “Great Act,” Law No. 753, passed in 1862.⁷⁹ This law recognized the centuries-old operation of *Opere Pie*, which were charities that supported the poor and provided health and social services, and granted significant autonomy to these organizations.⁸⁰ Savings banks and provident loan societies were also operated as nonprofits throughout much of Italy’s history.⁸¹ Mutual benefit societies, which functioned to insure members against unemployment and health problems, became very popular late in the 19th century.⁸² Credit and consumer cooperatives also were widespread by the 1800s.⁸³

Despite this initial boon for nonprofits, Italy deliberately and substantially scaled back the role of its third sector near the beginning of the 20th century. Inspired by the French Revolution and the German model of social democracy, Italians questioned whether intermediaries like nonprofits would “obstruc[t] the direct relationship between the state and the citizen.”⁸⁴ The rise of Fascism in the 20th century also operated to

74. *Id.*

75. *Id.* at 61 n.6.

76. *Id.* at 55.

77. *Id.* at 45, 61 n.6 (citations omitted).

78. Borzaga, *supra* note 65, at 59.

79. *Id.* at 48.

80. *Id.*

81. *Id.* at 49.

82. *Id.*

83. *Id.*

84. Borzaga, *supra* note 65, at 52.

greatly eliminate the autonomy and success of nonprofits. It was not until the end of the 20th century that the modern Italian third sector emerged.⁸⁵

Italy was the first European country to introduce legislation that placed little to no restrictions on associations participating in commercial activities.⁸⁶ These laws aim to “encourage the entrepreneurial and commercial provision of social and welfare services and to increase the participation of women in labor markets, whilst involving various stakeholders (workers, voluntary workers, target groups, and municipalities) in the production process.”⁸⁷ This legislation has been successful in increasing not only the number of these organizations but their benefits to the Italian population.⁸⁸ Although commercial activity is allowed, it “should not be aimed at making a monetary profit, but exclusively at obtaining the association’s purpose. If the commercial activities are autonomous in relation to the purpose of the association, it may be considered a *de facto* company with taxation and social obligations.”⁸⁹ Members of the association do not have the right to share in the profits.⁹⁰

Italy does offer some modest tax benefits to encourage philanthropic institutions and their donors, but these benefits are a recent addition rather than the centerpiece of national nonprofit law. In 1991, the Act on Voluntary Organizations (no. 266) granted tax benefits to certain nonprofits and their donors, but delayed implementation of this tax relief until 1997.⁹¹ Arguably, there is still no “significant” tax relief or subsidy to support the third sector in Italy.⁹²

4. Sweden

A person might assume that Sweden, with its reputation for full-scale governmental services, has little need for nonprofit organization. On the contrary, Sweden has a robust and well-organized charitable sector.⁹³ The role of the voluntary association is critical, and roughly 90% of the

85. *Id.*

86. Kerlin, *supra* note 19, at 254.

87. *Id.* (citation omitted).

88. *Id.*

89. *See* Kerlin, *supra* note 35, at 17.

90. *See id.*

91. Borzaga, *supra* note 65, at 54.

92. *Id.* at 46.

93. *See generally* Victor Pestoff, *The Development and Future of the Social Economy in Sweden*, in *THE THIRD SECTOR IN EUROPE*, *supra* note 20, at 63–82.

population is a member in at least one voluntary organization.⁹⁴ That said, Swedish nonprofits do focus less on provision of services than many other European countries.⁹⁵

The central role voluntary organizations play in Sweden relates to shaping public policy. Rather than allocate resources toward the provision of social services like several nations do, many of Sweden's nonprofits focus instead on improving government by providing coordinated participation in policy making.⁹⁶ Swedish nonprofits may act as "pressure groups" that highlight a group's position on potential legislation, and undertake activities ranging from lobbying and dissemination of information to direct engagement with the drafting or application of laws.⁹⁷ The tradition of nonprofit organizations in Sweden is deeply tied to a history of civic engagement with popular movements.⁹⁸

Some Swedish organizations do provide social support, along the lines of the American conception of nonprofits. Organizations such as the Salvation Army provide shelter and services to the homeless, and groups like Alcoholics Anonymous focus on rehabilitation of those with drinking problems.⁹⁹ Even these service-focused organizations have a Swedish flavor, however, and focus more on the recognition of the rights of disadvantaged individuals, rather than the beneficence of those who support them.¹⁰⁰

The history of the third sector in Sweden is relatively young, with few voluntary associations recognized prior to the 1800s.¹⁰¹ Before the Reformation, charitable endeavors were within the purview of the Church,

94. *Id.* at 63.

95. *Id.* at 79.

96. *Id.* The ability of Swedish nonprofit organizations to engage in political activities "can result in these organizations 'focusing on lobbying and acting as pressure groups to influence different levels of government to provide services than on actually providing these services themselves.'" Crimm, *supra* note 37, at 664 n.327 (quoting Tommy Lundström & Filip Wijkström, *Sweden*, in *DEFINING THE NONPROFIT SECTOR: A CROSS-NATIONAL ANALYSIS* 215, 241 (Lester M. Salomon & Helmut Anheir eds., 1997)). Due to the duality of nonprofits, "the ties are close, and sometimes nearly indistinguishable, between government and the nonprofit organization." *Id.*

97. Pestoff, *supra* note 93, at 80.

98. *Id.* at 64-68.

99. *Id.* at 72.

100. *Id.* Some Swedes hold the viewpoint that charity is "the poor being forced by circumstances to accept gifts from the rich." *Id.* at 69. They prefer to focus instead upon self-help and entitlement programs, rather than "charity" as a means of providing needed support. *Id.* This focus may be part of the reason why, unlike most other Western countries that grant some type of income tax relief to promote charitable giving, Sweden does not provide any charitable relief for charitable contributions. Ilan Benshalom, *The Dual Subsidy Theory of Charitable Deductions*, 84 *IND. L.J.* 1047, 1048 & n.2 (citing LESTER M. SALAMON, *THE INTERNATIONAL GUIDE TO NONPROFIT LAW* (1997)).

101. Pestoff, *supra* note 93, at 68.

and then the Crown.¹⁰² Throughout the nineteenth century, charitable societies and associations evolved but were primarily headed by the social elite.¹⁰³ Following industrialization near the end of that century, voluntary associations became more democratic and a broader source of collaboration for individuals of all classes.¹⁰⁴ Upon the formation of the Swedish welfare state in the middle of the twentieth century, however, “many services were turned into rights and made available to most citizens,” and the role for voluntary associations diminished.¹⁰⁵ Within the past half-century, the voluntary sector appears to be again gaining force, filling in the niches left behind by the public sector and contributing to a “growing welfare mix.”¹⁰⁶

B. The Third Sector in Asia

South Asia, as a collection of several distinct developing countries currently evolving with respect to the role of the third sector, offers an intriguing opportunity for study. The tensions between the third sector and the state are perhaps more raw in this region, and the regulation of nonprofits more strategic.

1. India

India is a country of contrasts. Its position in the world economy is elevating, yet the needs of its poor are abundant. Much emphasis in India is on the market sector and the impact of globalization on Indian growth. There remains, however, substantial demand for social services that are unmet by either the state or the market—and a natural role for the third sector to fill.¹⁰⁷

102. *Id.*

103. *Id.* at 68–69. This period of elitist philanthropy lasted roughly from 1810 to 1870. *Id.*

104. *Id.* at 69. Many of these organizations were engaged in furthering the goals of social movements, such as temperance organizations and trade unions. *Id.*

105. *Id.* at 71. Most voluntary associations supported the assumption of these responsibilities by the government. *Id.*

106. *Id.* Unlike the availability of Italian nonprofit organizations to engage in commercial activity, the Swedish nonprofit organizations that engage in business activity may only do so as long as these activities are not commercial. See Kerlin, *supra* note 35, at 18. In addition, the organization will have to pay taxes on the business activities that have no relationship to the nonprofit activity.

107. On India’s struggle to influence nonprofit sector regulation through judicial action, see generally Mark Sidel, *States, Markets, and the Nonprofit Sector in South Asia: Judiciaries and the Struggle for Capital in Comparative Perspective*, 78 TUL. L. REV. 1611 (2004).

The right to join and form associations is guaranteed by the Constitution of India.¹⁰⁸ Indian nonprofit law requires that voluntary organizations register with the government; most registration requirements are at the state level.¹⁰⁹ Charitable trusts are also subject to regulation through state public trusts acts.¹¹⁰ Voluntary organizations are granted exemption from income tax, and individual donors may receive income tax deductions for qualifying donations.¹¹¹ Although at first glance the regulatory structure may seem similar to the American model, the role of government in controlling nonprofits is in fact significantly stronger.

The primary source of the power of the Indian government over voluntary organizations is the Foreign Contribution (Regulation) Act of 1976 (FCRA).¹¹² Unlike American charities, most Indian nonprofits either receive or want to receive foreign funds.¹¹³ Intermediary foreign charities, such as Save the Children, Oxfam, and Charities Aid Foundation, collect donations from American, European, and other foreign donors and stand in a position to provide financial support to Indian nonprofits.¹¹⁴ If an Indian nonprofit wants to accept this source of funding—and many or most do—they must submit to the strictures of the FCRA.

The FCRA requires that a nonprofit register with the central government's Ministry of Home Affairs in order to be eligible to receive foreign donations.¹¹⁵ Unregistered nonprofits may accept a foreign contribution on a one-time basis if they are granted "prior permission" by the Ministry.¹¹⁶ The Ministry interprets the language of the FCRA and can bring enforcement actions in court.¹¹⁷ The Act requires not only

108. INDIA CONST. art. 19, cl. 1(c). This right to form associations was, however, temporarily limited in the 1970s when Prime Minister Indira Gandhi imposed an "emergency rule" that "suspended civil liberties, and banned and disbanded a range of nongovernmental organizations." Sidel, *supra* note 107, at 1619 (citing CHARLES R. EPP, *THE RIGHTS REVOLUTION: LAWYERS, ACTIVISTS, AND SUPREME COURTS IN COMPARATIVE PERSPECTIVE* 96 (1998)).

109. The Societies Registration Act, No. 21 of 1860, INDIA CODE (1860); *see also* Sidel, *supra* note 107, at 1619.

110. *See id.*

111. The Income Tax Act, No. 43 of 1961, *amended by* The Finance Act, No. 32 of 2003, INDIA CODE (2003); *see also* Sidel, *supra* note 107, at 1619.

112. *See generally* The Foreign Contribution (Regulation) Act, No. 49 of 1976, INDIA CODE (1976), *available at* <http://www.accountaid.net>.

113. *See* Sidel, *supra* note 107, at 1620–21.

114. *See* SAVE THE CHILDREN, <http://www.savethechildren.in/> (last visited Jan. 21, 2011); OXFAM INDIA, <http://www.oxfamindia.org/> (last visited Jan. 21, 2011); CAF INDIA, <http://www.cafindia.org/> (last visited Jan. 21, 2011) (for information on Charities Aid Foundation—India).

115. *See* The Foreign Contribution (Regulation) Act, No. 49 of 1976, pmb1., INDIA CODE (1976).

116. *Id.* ch. 2, §§ 10–11.

117. *See* The Foreign Contribution (Regulation) Rules, 1976, Gazette of India, section III(2), ch. 4, r. 6 (Aug. 5, 1976).

registration, but continued reporting and compliance, including the maintenance of only one bank account to hold foreign funds.¹¹⁸

The Ministry's interpretation of the language of the statute and approval or denial of requests is highly discretionary and largely unfettered. Although a High Court decision found that the role of the Ministry should be purely "administrative" and allow only minimal exercise of discretion, with registration routinely granted so long as applications were accurate,¹¹⁹ a compromise in the litigation spurring this case led to this decision being of no binding precedent.¹²⁰ The Ministry has issued guidelines upon which FCRA registration may be denied, but these rules still leave ample room for discretion.¹²¹

The registration requirements of the FCRA require nonprofits to submit to multiple levels of review and approval, with decision-makers at each phase of the process granted largely unlimited discretion. Before an FCRA application is submitted to the Ministry, the nonprofit must first obtain a "political no-objection" certificate from the regional district collector (a local official).¹²² The official is asked to certify that the "antecedents of the organization have been verified and there is nothing adverse against them," that it has done "welfare activities" in the local area, and that the "project would be beneficial to the people living in the [local] area."¹²³ Discretionary language along these lines rests substantial power in the hands of local officials, who may be corruptible to varying degrees.

118. See *Cent. Bureau of Investigation & Anr v. M. Kurian Chief Functionary of the Cross, Special Leave Petition (crl.) 84-86 of 2001 (India)* (holding that a nonprofit violated the Act by maintaining multiple bank accounts).

119. *Calcutta Rescue v. Union of India, Calcutta H.C., Mar. 20, 1996* (Supreme Court Litigation File 1-55).

120. *Order of the Supreme Court of India, Union of India v. Calcutta Rescue, Nov. 8, 2001* (Supreme Court Litigation File 250-51).

121. See Sidel, *supra* note 107, at 1650. Sidel found that:

Listed grounds for denial included links to another prohibited organization, propagation of sedition or violence, creation of communal tension or disharmony, links to family organizations, conviction or current prosecution of principal officers, conversion activities, organization in the formative stage, . . . fictional organizations, the presence of foreign citizen officeholders or chief executives, and total annual organizational expenditures of less than 75,000 rupees. The breadth of these procedures vitiates any specificity or real process that their release implies and leaves the Home Ministry free to deny registration or other benefits of the Act to virtually any organization it chooses.

Id. at 1650 n.118.

122. *Id.* at 1642.

123. *Id.* at 1642 n.100 (citing VOLUNTARY ACTION NETWORK INDIA, *A Note of the Background to the Drafting of Model Bill for Registration of Societies in India*, Prepared for the National Meeting on Creating Conducive Legal Environment for the Voluntary Sector 3 (Mar. 16-17, 2000)).

As a practical matter, the most efficient and least expensive manner of obtaining favorable governmental treatment of nonprofits is through bribery.¹²⁴ The “expected relationships with regulatory authorities,” in which decision-makers are persuaded through bribes, can frustrate nonprofits intent on operating by the book.¹²⁵

2. Bangladesh

Bangladesh is by all appearances a nation in transition—one that is exploring the options the nonprofit sector has to offer and is testing the boundaries of its role. Bangladeshi law recognizes the organization and operation of nonprofit societies. The Societies Registration Act of 1860 provides for the registration of the following societies:

Charitable societies[,] . . . societies established for the promotion of science, literature, or the fine arts, for instruction, the diffusion of useful knowledge[,] . . . the foundation or maintenance of libraries or reading rooms for general use among the members or open to the public, or public museum and galleries of painting and other works of art, collections of natural history, mechanical and philosophical inventions, instruments, or designs.¹²⁶

A recent struggle has occurred under Bangladeshi law related to the commercial activities of nonprofit organizations. A large and powerful nonprofit, the Bangladesh Rural Advancement Committee (BRAC), was granted a license by the government to operate a bank.¹²⁷ It was previously unclear whether nonprofit societies were authorized to engage in such commercial activities, and if so, the extent to which they would be taxed.¹²⁸ The courts resolved the issue largely in favor of the nonprofit, authorizing its commercial banking activities despite lacking a direct connection to its charitable mission.¹²⁹ The court seemed persuaded by the

124. The multiple-level license procurement process offers opportunities for the license providers to “harass” applicants for the license. *See* Sidel, *supra* note 107, at 1625 n.30 (citing VOLUNTARY ACTION NETWORK INDIA, *A Note of the Background to the Drafting of Model Bill for Registration of Societies in India*, Prepared for the National Meeting on Creating Conducive Legal Environment for the Voluntary Sector 7 (Mar. 16–17, 2000)).

125. Sidel, *supra* note 107, at 1642.

126. The Societies Registration Act, No. 21 of 1860, § 20 INDIA CODE (2003).

127. For an extensive discussion of the BRAC bank controversy, see Sidel, *supra* note 107, at 1651–68.

128. The Societies Registration Act did not list banking as a permissible activity of a nonprofit, so Professor Ahmed argued that the actions were outside the scope of a nonprofit society. *See* Sidel, *supra* note 107, at 1656.

129. The High Court Division held that the banking activities were not permitted by a nonprofit

nonprofit's desire to support itself, rather than to rely on contributions from (largely foreign) donors.¹³⁰

The tax issue was also of serious consequence. If a nonprofit can compete with a for-profit on commercial grounds, are the receipts tax-exempt, giving the nonprofit a strong competitive advantage? Although the original answer seemed to be yes, the Finance Act of 1999 levied a tax on nonprofit commercial income.¹³¹ Voluntary associations must now pay a tax of 25% on receipts from commercial income, and may then dedicate the balance to their nonprofit work.¹³² Nonprofits remain exempt from federal taxes on income derived from their property, so long as the income is used entirely for religious or charitable purposes.¹³³ Today, tax exemption has been expanded to include "all philanthropic and educational institutions approved by the government."¹³⁴ This expansion in the tax provision should increase the availability of resources to the nonprofit sector.¹³⁵

Social business and enterprise, which can entail the cooperation of the second and third sectors, is taking on a growing importance in Bangladeshi society. While the types of social business vary, some of the more prominent examples in Bangladesh include:

[T]he Grameen businesses pioneered by Muhammad Yunus who won the Nobel Peace Prize for his microcredit bank Grameen Bank, which he founded along with Grameen Shakti of Grameen Energy, which has brought renewable energy to Bangladesh; Grameen Kalyan (Grameen Welfare) bringing affordable healthcare to the

association. See *Ahmed v. Bangladesh Bank*, 20 BLD (HCD) 235 (Bangl. H.C. 2000). The Supreme Court, however, disagreed. *BRAC v. Ahmed*, 7 MLR (AD) 49, 54 (Bangl. 2002).

130. See *id.*

131. See *id.* (discussing the application of the new Finance Act of 1999 to BRAC).

132. Sidel, *supra* note 107, at 1658 (citing *BRAC v. Ahmed*, *supra* note 129, at 70.).

133. Sidel, *supra* note 107, at 1657 (citing Sumaiya Khair & Saira Rahman Khan, *Philanthropy and Law in Bangladesh*, in *PHILANTHROPY AND LAW IN SOUTH ASIA* (Mark Sidel & Iftekhar Zaman eds., 2004)).

134. Sanjay Agrival et al., *Asia Pacific Philanthropy Consortium, Philanthropy and Law in South Asia—Recent Developments in Bangladesh, India, Nepal, Pakistan and Sri Lanka* 14 (Sept. 2007), available at <http://www.istr.org/news/pdf/PALISA%20Update%20Workshop%20Report.pdf>. Under the new approval process:

NGOs shall submit a written application to the National Bureau of Revenue profiling their activities, and the Bureau shall decide whether the contributions in question qualify for a tax deduction. Needless to say, this process requires careful scrutiny and strict monitoring since it involves considerable discretion in delineating what constitutes an eligible philanthropic or educational institution.

Id.

135. *Id.* at 15.

poor in Bangladesh, which has spawned a network of for-profit and nonprofit social businesses dedicated to transforming the health of the poor; and recently Grameen Danone, a social business partnership with Groupe Danone, the French yogurt conglomerate, which provides low cost highly nutritious food for the poor.¹³⁶

In today's economic downturn, "the social business has proven to be an effective way for charities to sustain themselves and their missions in an era where government downsizing has deprived them of an important source of support."¹³⁷ The growth of the nonprofit sector in Bangladesh can be attributed to the sector's increasing participation in advocacy and government and continued efforts in poverty reduction.¹³⁸

3. *Pakistan, Nepal, and Sri Lanka*

Although these three Southeast Asian countries are distinctive, this discussion will treat them briefly and together. Pakistan, Nepal, and Sri Lanka share certain challenges and opportunities.¹³⁹ All face substantial state control over permissibility of investments.¹⁴⁰ Each has a modest tax system dogged by multiple levels of bureaucracy and noncompliance.¹⁴¹ And each exerts a significant amount of discretionary authority over its nonprofits through registration procedures.¹⁴²

Pakistan offers a wide variety of organizational forms for nonprofit organizations, which may be organized as trusts, societies, companies, endowments, cooperatives, voluntary social welfare agencies, or in other

136. Barbara K. Bucholtz, *Doing Well by Doing Good and Vice Versa: Self-Sustaining NGO/Nonprofit Organizations*, 17 J.L. & POL'Y 403, 441 n.133 (2009).

137. *Id.* at 441. Another one of the success stories has been the introduction of the Silk Development Project. See Rie Makita, *New NGO-Elite Relations in Business Development for the Poor in Rural Bangladesh*, 20 VOLUNTAS 50, 55 (2009). Along with assistance from the Bangladeshi government and the World Bank, the Bangladesh Silk Foundation (a nonprofit organization) established this program to aid rural women in reviving the silk industry. *Id.* (stating that the "Bangladesh Silk Foundation does not support producers directly, but works through NGOs with established internal silk production programs").

138. Agrival et al., *supra* note 134, at 6.

139. See generally Mark Sidel & Iftexhar Zaman, *Philanthropy and Law in South Asia: Key Themes and Key Choices*, 7(2) INT'L J. NOT-FOR-PROFIT L. 38 (2005) [hereinafter *Key Themes and Key Choices*]. This Article, in turn, draws heavily upon PHILANTHROPY AND LAW IN SOUTH ASIA (Mark Sidel & Iftexhar Zaman eds., 2004), particularly Anil Kumar Sinha & Sapana Pradham Malla, *Philanthropy and Law in Nepal*, at 214–28, Aritha Wikramanayake, *Philanthropy and Law in Sri Lanka*, at 325–56, and Zafar Hameed Ismail & Quadeer Baig, *Philanthropy and Law in Pakistan*, at 288–322.

140. *Key Themes and Key Choices*, *supra* note 139, at 50–51.

141. *Id.* at 47–49.

142. *Id.* at 45–46.

forms.¹⁴³ Nepal, likewise, offers substantial flexibility to nonprofits in organizational form. Nonprofits may organize as cooperatives, societies, statutory trusts, or formed trusts.¹⁴⁴ Sri Lanka allows for creation of nonprofits through acts of Parliament, or organization as trusts, cooperatives, societies, or companies.¹⁴⁵ Private companies are an increasingly popular choice for participating in the voluntary sector in Sri Lanka, because of the limited liability, management control, and confidentiality characteristics of the form.¹⁴⁶

The relative diversity and flexibility in selecting nonprofit organizational forms that Sri Lanka, Nepal, and Pakistan share leads these countries to a similar predicament. For each of these countries, each form of organization “has its own vertical structure of government monitoring and regulation.”¹⁴⁷ Nonprofit organizations with similar aims and operations may face different regulators with varying degrees of oversight and control. Arittha Wikramanayake, who has studied nonprofits in Sri Lanka, has commented that a key drawback of the regulatory system is the “multiplicity of regulators, the overlapping of laws and regulations and lack of common standards . . . [and] the creation of considerable opportunities for ‘regulatory arbitrage’ that even extend as far as non-regulation,” in which nonprofits are “permitted to operate under varying degrees of regulatory conformity.”¹⁴⁸

All three countries offer some tax benefits to the nonprofit sector and its donors, but vary as to how consistently the system is applied.¹⁴⁹ Pakistan requires discretionary exemption procedures, where tax authorities at multiple levels of government (central, regional, and local) wield significant authority and control.¹⁵⁰ Although Sri Lanka provides tax exemptions and deductions to support charitable giving and charitable organizations, these tax incentives play only a nominal role in nonprofit regulation.¹⁵¹ The low level of tax compliance—only 150,000 registered

143. *Id.* at 42.

144. *Id.*

145. *Id.*

146. *Key Themes and Key Choices*, *supra* note 139, at 50 (citing Wikramanayake, *supra* note 139, at 340).

147. *Id.* at 42.

148. *Id.* (citing Wikramanayake, *supra* note 139, at 347–48).

149. *Id.* at 47–49.

150. *Id.* (citing Ismail & Baig, *supra* note 139, at 286, 288). “Speed money” is often expected by government administrators to streamline the informal process. Ismail & Baig, *supra* note 139, at 288.

151. *Key Themes and Key Choices*, *supra* note 139, at 49.

taxpayers in a country of over 18 million—necessarily makes tax incentives moot for the majority of the population.¹⁵²

In Nepal, nonprofits are exempt from a value-added tax and from taxes on cooperatives, but, although the exemption is statutory, nonprofits must *apply* for the right to the exemption.¹⁵³ These application and registration procedures to obtain exemption rest continued control and discretion in the Nepalese government.¹⁵⁴ The tax law is vague enough as to the exemption requirements to allow substantial decision-making authority by the state, and permits delay, corruption, and inequality in treatment.¹⁵⁵ In limited circumstances, donors to charitable organizations in Nepal may be entitled to tax deductions.¹⁵⁶

All three countries require registration with the government for new nonprofits.¹⁵⁷ Nepal offers centralized statutory procedures for nonprofit registration, but the system retains a good deal of discretion in the hands of the bureaucratic administration.¹⁵⁸ The formalities and requirements for organization often have no particular time frame and little specificity, which can lead to delay or abuse of power.¹⁵⁹ The Nepalese government retains control over its nonprofits through its right to terminate them; if a nonprofit is voluntarily or involuntarily dissolved, its assets (after payment of obligations) pass to the state.¹⁶⁰

The Sri Lankan government retains significant ongoing control over its nonprofits through its broad authority to terminate, take over, or dissolve nonprofits on a wide variety of grounds that allow ample government discretion.¹⁶¹ There is some deterrence to abuse of this discretion, as nonprofits may challenge government action in court, but the government retains significant power over nonprofits through this mechanism.¹⁶² Pakistan wields similar control to exercise management takeover rights,

152. *Id.* (citing Wikramanayake, *supra* note 139, at 357, 363–64). The level of tax evasion in Sri Lanka calls into question “whether the tax law itself would be sufficient to make any real impact on public participation in philanthropic and nonprofit activity,” and “makes the whole system of taxes a subject of ridicule.” Wikramanayake, *supra* note 139, at 364.

153. *Key Themes and Key Choices*, *supra* note 139, at 47–48 (citing Sinha & Malla, *supra* note 139, at 226–28).

154. *Id.* at 48.

155. *Id.* (citing Sinha & Malla, *supra* note 139, at 226–28).

156. *Id.* at 48.

157. *Id.* at 42.

158. *Id.* at 44 (citing Sinha & Malla, *supra* note 139, at 210).

159. *Key Themes and Key Choices*, *supra* note 139, at 44.

160. *Id.* at 47 (citing Sinha & Malla, *supra* note 139, at 214).

161. *Id.* at 46 (citing Wikramanayake, *supra* note 139, at 351).

162. *Id.*

and a more serious issue of arbitrary and effectively unreviewable government action.¹⁶³

Nonprofits throughout Asia and Europe, though clearly unique in the administrative details, share certain key similarities in their regulatory goals. The above discussion highlights how each country struggles with the balance of power between first sector and third sector—between state and nonprofit. This is a primary focus of nonprofit regulation in each country discussed, although the means to the ends vary greatly. We turn now to a discussion of American nonprofit law, which, as we shall see, diverges from this shared regulatory priority.

III. AMERICAN NONPROFIT LAW

The third sector is a substantial part of the U.S. economy. In 2006, charitable nonprofits, excluding private foundations, reported \$1.4 trillion in revenue and \$2.5 trillion in assets.¹⁶⁴ The majority of revenue (\$920.6 billion) was derived from program services (fees received for charitable programs).¹⁶⁵ Private foundations are also on the rise, with Form 990-PF¹⁶⁶ filers increasing 3% between 2004 and 2006.¹⁶⁷

The U.S. third sector has a dualist approach to governance, with regulation at both the state and national levels.¹⁶⁸ This approach “bifurcates responsibility for regulating” nonprofits between state government and federal government.¹⁶⁹ This Article will first introduce the basics of state nonprofit law, and then discuss the federal regulatory scheme.

163. *Id.* at 47 (citing Ismail & Baig, *supra* note 139, at 322).

164. *IRS Statistics of Income Bulletin*, 29 SOI Bulletin 2 (May 2007), available at <http://www.irs.gov/taxstats/article/0,,id=215634,00.html>; see also *Estate Planning Newsletter* 1550, LEIMBERG INFO. SERVS., INC., Nov. 24, 2009, available at <http://www.leimbergservices.com>.

165. See *IRS Statistics of Income Bulletin*, *supra* note 164.

166. The Form 990-PF is the annual informational return that private foundations must submit to the IRS; it is available at <http://www.irs.gov/pub/irs-pdf/f990pf.pdf> (last visited Jan. 21, 2011).

167. See *IRS Statistics of Income Bulletin*, *supra* note 164.

168. See Brian D. Galle, *Foundation or Empire? The Role of Charity in a Federal System* (FSU College of Law; Public Law Research Paper No. 394, Law, Business & Economics Paper No. 09-25, 2010), available at <http://ssrn.com/abstract=1473107>.

169. Gary Jenkins, *State-Level Legal Reform of the Law of Nonprofit Organizations: Incorporation Choice, Uniformity, and the Reform of Nonprofit State Law*, 41 GA. L. REV. 1113, 1125 (2007).

A. State Regulation

The state regulation of nonprofit organizations is structured to support the role of charities in society while providing some protections against abuse. The effectiveness of regulation varies widely among the states, as do the resources allocated to enforcement. Broadly, state law governs how charitable organizations may be created, the form they may take, the fiduciary duties of their leaders, and regulation of their continued operation.

A charity in America is generally organized as either a trust or a corporation,¹⁷⁰ with the corporation as the most common form.¹⁷¹ Regardless of the organizational form, the purposes must be charitable.¹⁷² State law often frames the notion of what constitutes a charitable purpose with reference to the Statute of Charitable Uses of 1601.¹⁷³ The current Restatement of Trusts rule is similar: “charitable purposes” includes “(a) the relief of poverty; (b) the advancement of knowledge or education; (c) the advancement of religion; (d) the promotion of health; (e) governmental or municipal purposes; and (f) other purposes that are beneficial to the community.”¹⁷⁴

Statutes setting forth requirements of nonprofit purposes of corporations are generally consistent, although there is variation as to the degree of detail. Many statutes take an approach similar to that of the Restatement and the Statute of Charitable Uses, listing certain purposes

170. Limited liability companies are treated as corporations and may also serve as the form of a charitable organization. See INTERNAL REVENUE SERV., CONTINUING PROFESSIONAL EDUCATION TEXT 111 (2000).

171. See Moody, *supra* note 3, at 1354.

172. See Matter of Rockefeller’s Estate, 165 N.Y.S. 154, 157 (App. Div. 1917), *aff’d*, 119 N.E. 1074 (N.Y. 1918) (stating that “the test of a charitable gift or use and a charitable corporation are the same”).

173. Charitable Uses Act, 1601, 43 Eliz. I, c. 4 (Eng.). The preamble to the statute lists as charitable purposes:

Releife of aged impotent and poore people, some for Maintenance of sicke and maymed Souldiers and Marriners, Schooles of Learninge, Free Schooles and Schollers in Universities, some for Repaire of Bridges Portes Havens Causwaies Churches Seabankes and Highwaies, some for Educacion and prefermente of Orphans, some for or towardes Reliefe Stocke or Maintenance of Howses of Correccion, some for Mariages of poore Maides, some for Supportacion Ayde and Helpe of younge tradesmen Handicraftesmen and persons decayed, and others for reliefe or redemption of Prisoners or Captives, and for aide or ease of any poore Inhabitantes concerninge paymente of Fifteenes, setting out of Souldiers and other Taxes

Id.

174. See RESTATEMENT (THIRD) OF TRUSTS § 28 (2003).

that are traditionally considered charitable.¹⁷⁵ Others make reference to the definition contained in the Internal Revenue Code.¹⁷⁶ The Revised Model Nonprofit Corporation Act (“RMNCA”), however, takes a broader approach in its definitions, such that corporations are broadly categorized as religious, public benefit, or mutual benefit organizations.¹⁷⁷ Reference is then made to state law as to what constitutes a “charitable” disposition.¹⁷⁸

Charitable corporations require authorization from the state in order to be created.¹⁷⁹ Incorporation of nonprofit corporations is similar to the process for for-profit ones, with instruments being filed with the Secretary of State or other state official.¹⁸⁰ The application often requires only minimal information including the organization’s purposes and powers, as well as contact information for the directors and members.¹⁸¹ Upon filing the proper paperwork and fees, the incorporator will receive a charter or certificate of incorporation issued by the state official.¹⁸²

Although charities may be structured in either the trust form or the corporate one, the fiduciary duties of their trustees or officers are similar.¹⁸³ American trust law is relatively consistent across the states with respect to fiduciary duties, due in part to the “statutorification” of trust law around the turn of the millennium.¹⁸⁴ The two key fiduciary norms are the duties of prudence and loyalty.¹⁸⁵ The duty of loyalty requires trustees to

175. See, e.g., 805 ILL. COMP. STAT. § 105/103.05 (2006).

176. See, e.g., 805 ILL. COMP. STAT. § 105/103.05(a)(31) (1986) (authorizing as a valid charitable purpose of a nonprofit corporation “any purpose permitted to be exempt from taxation under Sections 501(c) or 501(d) of the United States Internal Revenue Code . . .”).

177. REVISED MODEL NONPROFIT CORPORATION ACT § 3.01(a) (1987).

178. REVISED MODEL NONPROFIT CORPORATION ACT § 2.02(2) (1987).

179. See, e.g., COLO. REV. STAT. § 7-122-101 (2002); ME. REV. STAT. ANN. tit. 13-B § 404 (2004); see also MARION FREMONT-SMITH, GOVERNING NONPROFIT ORGANIZATIONS: FEDERAL AND STATE LAW AND REGULATION 152 (2004).

180. FREMONT-SMITH, *supra* note 179, at 152.

181. *Id.*

182. *Id.*

183. See Evelyn Brody, *Charity Governance: What’s Trust Law Got to Do with It?*, 80 CHI.-KENT L. REV. 641, 686 (2005) (“The fiduciary standards for trustees of charitable trusts and for directors of corporate charities are more similar than commonly believed.”). For more on fiduciary duties and their limits, see generally Melanie B. Leslie, *Trusting Trustees: Fiduciary Duties and the Limits of Default Rules*, 94 GEO. L.J. 67 (2005).

184. John H. Langbein, *Why Did Trust Law Become Statute Law in the United States?*, 58 ALA. L. REV. 1069, 1078 (2007).

185. *Id.* at 1077. In addition to adhering to the duties of loyalty and prudence, trustees of charitable trusts must also respect several administrative duties. The Restatement sets forth these administrative duties as follows:

(1) The trustee has a duty to administer the trust, diligently and in good faith, in accordance with the terms of the trust and applicable law.

administer trust property only in the interest of the beneficiaries, or in the case of a charitable trust, only in furtherance of its charitable purposes.¹⁸⁶

The duty of prudence requires that a trustee “administer the trust as a prudent person would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution.”¹⁸⁷

The RMNCA is similar in its emphasis on prudence and loyalty, and requires that nonprofit directors discharge their duties “(1) in good faith; (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (3) in a manner the director reasonably believes to be in the best interests of the corporation.”¹⁸⁸ The RMNCA is consistent with well-established norms of fiduciary behavior,¹⁸⁹ but is more closely aligned with corporate law than trust law.¹⁹⁰

The duties owed by charitable leaders are enforced by state courts, as described in the following section. The sources of regulation at the state level are concentrated largely in the courts and the Attorney General’s office. Unlike private trusts, a charity organized as a trust does not have beneficiaries; therefore, enforcement of charitable trusts differs from private trusts.¹⁹¹ Because of the lack of ascertainable beneficiaries, a “suit can be maintained for the enforcement of a charitable trust by the Attorney General or other public officer, or by a co-trustee, or by a person who has

(2) In administering the trust, the trustee’s responsibilities include performance of the following functions:

- (a) ascertaining the duties and powers of the trusteeship, and the beneficiaries and purposes of the trust;
- (b) collecting and protecting trust property;
- (c) managing the trust estate to provide returns or other benefits from trust property; and
- (d) applying or distributing trust income and principal during the administration of the trust and upon its termination.

RESTATEMENT (THIRD) OF TRUSTS § 76 (2003). The trustees must also provide accountings to the beneficiaries. *See* RESTATEMENT (THIRD) OF TRUSTS § 82 (2003).

186. RESTATEMENT (THIRD) OF TRUSTS § 170(1) (2003); *see also* RESTATEMENT (THIRD) OF TRUSTS § 78 (Duty of Loyalty) (Council Draft No. 4, Nov. 10, 2004).

187. UNIFORM TRUST CODE § 804 (2000); *see also* RESTATEMENT (THIRD) OF TRUSTS § 77 (2003).

188. REVISED MODEL NONPROFIT CORP. ACT 830(a) (1987).

189. *See* Moody, *supra* note 3, at 1337. Some commentators do stress, however, the differences between trust law and corporate law. *See id.*

190. The drafters of the RMNCA deliberately rejected trust law language in favor of a standard consistent with general corporate law. Susan N. Gary, *Regulating the Management of Charities: Trust Law, Corporate Law, and Tax Law*, 21 HAWAII L. REV. 593, 611 (1999).

191. *See id.* at 618 (1999) (discussing the differences between charitable and private trusts); *see also* JESSE DUKEMINIER ET AL., WILLS, TRUSTS, AND ESTATES 750 (7th ed. 2005).

a special interest in the enforcement of the charitable trust.”¹⁹² Despite the similarity in structure among the states as to how charities are regulated, the effectiveness of the regulation varies widely, depending upon how each state’s Attorney General carries out these enforcement duties.¹⁹³

State judicial power over corporate nonprofits is similar. Even when the corporate form is selected, there is an “existence of a trust for indefinite beneficiaries implicit in every charitable gift.”¹⁹⁴ Additionally, the state retains the power of visitation over all corporations, originating from its power to create them.¹⁹⁵ State statutes enhance this power by granting courts the power to dissolve corporations that take actions to injure the public or which exceed their powers.¹⁹⁶

Regulation through the courts gives the state some authority over operating nonprofit organizations. State court decisions effectively shape the limits of trustee powers and duties, proper investments, and the definition of charitable purpose.¹⁹⁷ In cases of severe abuse, a court may replace trustees or directors or dissolve a nonprofit entirely.¹⁹⁸ Whether a state exercises such powers over nonprofits, however, varies depending upon the resources allocated to enforcement.¹⁹⁹ The existence of the authority, therefore, does not mean that such authority is regularly exercised.

States regulate the relationship between their nonprofits and their citizens by requiring advance registration for solicitation of charitable funds.²⁰⁰ Many states have coordinated their approaches to registration for solicitation; several states will accept a uniform application.²⁰¹

States also regulate their nonprofits in the same manner that the federal government does—through tax benefits. States often grant exemptions

192. RESTATEMENT (SECOND) OF TRUSTS § 391 (1959).

193. See Jenkins, *supra* note 169, at 1128 (noting that most states allocate very little resources to charitable enforcement, with 74% of states having no more than one full-time attorney working on oversight of nonprofits); see also FREMONT-SMITH, *supra* note 179, at 301.

194. FREMONT-SMITH, *supra* note 179, at 303.

195. *Id.*

196. See MODEL BUSINESS CORPORATION ACT 14.30(2) (1995).

197. FREMONT-SMITH, *supra* note 179, at 302.

198. *Id.*

199. For a discussion of the variety of state enforcement regimes including California, New York, Ohio, Massachusetts, Illinois, and Texas, see *id.*, at 351–61.

200. See generally Richard Steinberg, *Economic Perspectives on Regulation of Charitable Solicitation*, 39 CASE W. RES. L. REV. 775 (1989).

201. The website for the National Association of State Charitable Officials provides a link to a unified registration statement for charitable solicitations. See NAT’L ASS’N OF STATE CHARITABLE OFFICIALS, <http://www.nasconet.org/> (last visited Jan. 21, 2011).

from income tax, property tax, and/or estate and inheritance taxes.²⁰² Many states grant exemption from property taxes for entities that meet the state requirements of charitable organizations, at least for property used for the charitable purpose.²⁰³

Certain nonprofit organizations, such as universities and hospitals, will have additional layers of state regulation. Universities, colleges, and schools, for instance, are often regulated by a state board of education; hospitals and health care agencies are overseen by state departments of health.²⁰⁴ These agencies are generally restricted as to the scope of their oversight.²⁰⁵

B. Federal Regulation

Federal philanthropy law in the United States is unapologetically tax-centric. Nonprofit law is commonly referred to as tax-exempt organizations law because of the regulatory force the Internal Revenue Code wields over nonprofits. The nonprofit committee of the American Bar Association is the Tax-Exempt Organizations Committee; it is a subcommittee of the Taxation Committee of the ABA. Many lawyers who practice in the area of nonprofits do so through the tax departments of large firms; practice groups are often referred to as Exempt Organizations groups.

Tax law substantially regulates and restricts the actions of nonprofits. The Internal Revenue Code lists the permissible purposes for nonprofit organizations,²⁰⁶ limits the private benefits of transactions in which nonprofits engage,²⁰⁷ and restricts the activities and investments of various types of nonprofit organizations.²⁰⁸ Failure to comply with tax provisions results in tax penalties or, worse, loss of recognition of tax-exempt status by the Internal Revenue Service.

Tax plays a key regulatory function not only in the operation of nonprofits, but also in their funding. Individuals receive a charitable deduction from federal income tax (and state income tax in some jurisdictions) for grants to qualifying nonprofit organizations.²⁰⁹

202. FREMONT-SMITH, *supra* note 179, at 130.

203. *See, e.g.*, OHIO REV. CODE ANN. § 5709.12.

204. FREMONT-SMITH, *supra* note 179, at 301.

205. *Id.*

206. *See* I.R.C. § 501 (2010).

207. *See* I.R.C. § 501(c)(3) (2010).

208. I.R.C. §§ 4941–4945 (2010).

209. *See* I.R.C. § 170(b) (2010).

Individuals also receive an unlimited deduction from federal estate and gift taxes for qualifying charitable contributions.²¹⁰ Corporations, likewise, have tax incentives to encourage charitable giving.²¹¹

An organization seeking the benefits of tax-exempt status must meet the Internal Revenue Code description of the types of organizations that qualify. Charitable organizations are described in section 501(c)(3), which exempts from tax:

Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.²¹²

The regulations provide that a valid charitable purpose includes “relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes.”²¹³ It may also include purposes to “lessen neighborhood tensions,” “to eliminate prejudice and discrimination,” “to defend human and civil rights secured by law,” and “to combat community deterioration and juvenile delinquency.”²¹⁴

Several other types of organizations,²¹⁵ which are not charitable but are still broadly considered part of the voluntary sector, also are granted

210. See I.R.C. §§ 2522, 2055 (2010).

211. See I.R.C. § 170(d)(2) (2010).

212. I.R.C. § 501(c)(3) (2010). Certain types of charities are described under other sections of the code, such as religious associations (I.R.C. § 501(d)) and cooperative hospital or educational organizations (I.R.C. § 501(e) and (f)).

213. Treas. Reg. § 1.501(c)(3)-1(d)(2)(1960).

214. *Id.*

215. Treasury Regulations section 501(c) alone describes twenty-eight different types of

freedom from taxation, at least for most activities.²¹⁶ Social welfare organizations are tax-exempt,²¹⁷ as are political organizations,²¹⁸ social clubs,²¹⁹ and farm cooperatives.²²⁰ Even charitable organizations described in section 501(c) of the Internal Revenue Code, however, remain taxable on income for business activities unrelated to their exempt purpose.²²¹

To be exempt from income taxation, a nonprofit must pass both the organizational and the operational requirements of the Internal Revenue Code. The organizational test requires that the governing documents of the organization limit its purposes to exempt ones (as described in the Code) and do not expressly empower the organization to undertake substantial activities other than ones in furtherance of those exempt purposes.²²² The

organizations that are exempt from tax, with 501(c)(3) charities the most widely known. The IRS summarizes the types of nonprofits that are granted tax benefits in Publication 557 and provides the following list:

501(c)(1): Corporations Organized Under Act of Congress (including Federal Credit Unions); 501(c)(2): Title Holding Corporation for Exempt Organization; 501(c)(3): Religious, Educational, Charitable, Scientific, Literary, Testing for Public Safety, to Foster National or International Amateur Sports Competition, or Prevention of Cruelty to Children or Animals Organizations; 501(c)(4): Civic Leagues, Social Welfare Organizations, and Local Associations of Employees; 501(c)(5): Labor, Agricultural, and Horticultural Organizations; 501(c)(6): Business Leagues, Chambers of Commerce, Real Estate Boards, etc.; 501(c)(7): Social and Recreational Clubs; 501(c)(8): Fraternal Beneficiary Societies and Associations; 501(c)(9): Voluntary Employees Beneficiary Associations; 501(c)(10): Domestic Fraternal Societies and Associations; 501(c)(11): Teachers' Retirement Fund Associations; 501(c)(12): Benevolent Life Insurance Associations, Mutual Ditch or Irrigation Companies, Mutual or Cooperative Telephone Companies, etc.; 501(c)(13): Cemetery Companies; 501(c)(14): State-Chartered Credit Unions, Mutual Reserve Funds; 501(c)(15): Mutual Insurance Companies or Associations; 501(c)(16): Cooperative Organizations to Finance Crop Operations; 501(c)(17): Supplemental Unemployment Benefit Trusts; 501(c)(18): Employee Funded Pension Trust (created before June 25, 1959); 501(c)(19): Post or Organization of Past or Present Members of the Armed Forces; 501(c)(21): Black Lung Benefit Trusts; 501(c)(22): Withdrawal Liability Payment Fund; 501(c)(23): Veterans Organization (created before 1880); 501(c)(25): Title Holding Corporations or Trusts with Multiple Parents; 501(c)(26): State-Sponsored Organization Providing Health Coverage for High-Risk Individuals; 501(c)(27): State-Sponsored Workers' Compensation Reinsurance Organization; 501(c)(28): National Railroad Retirement Investment Trust.

INTERNAL REVENUE SERV., PUBLICATION 557, TAX-EXEMPT STATUS FOR YOUR ORGANIZATION, at 65–66 (rev. Oct. 2008), available at <http://www.irs.gov/pub/irs-pdf/p557.pdf>.

216. Charities described in section 501(c)(3) are broadly granted exemption from taxation on income (with limited exceptions), but many other types of nonprofits remain subject to tax on investment and other categories of income. See I.R.C. §§ 512(a)(3)(A), 527(b), 1381 (2010).

217. I.R.C. § 501(c)(4) (2010).

218. I.R.C. § 527 (2010).

219. I.R.C. § 501(c)(7) (2010).

220. I.R.C. § 521 (2010).

221. I.R.C. § 511 (2010).

222. Treas. Reg. § 1.501(c)(3)-1(b)(1)(i) (1960).

exempt purposes may be narrower than those described in the Code but cannot be broader.²²³

The organizational test also entails certain restrictions on political activities and requirements for the use of its assets upon dissolution. The governing documents must not allow the charitable organization “to devote more than an insubstantial part of its activities to attempting to influence legislation by propaganda or otherwise,”²²⁴ or to participate or intervene in any political campaign.²²⁵ Upon dissolution of the organization, its assets must be used for an exempt purpose or distributed for a public purpose, and must not be distributed to the organization’s members or shareholders.²²⁶

The operational test requires that the organization engage “primarily in activities which accomplish” section 501(c)(3) exempt purposes.²²⁷ The language “primarily” is more lenient than the Internal Revenue Code language requiring “exclusive” operation for exempt purposes.²²⁸ An organization will fail the operational test “if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.”²²⁹

“Private inurement”²³⁰ has long been prohibited of charitable organizations.²³¹ Private inurement entails benefits conveyed on insiders of the organization that are not proportional to the services the insider provided.²³² It can exist in many contexts, including below-market sales²³³

223. Treas. Reg. § 1.501(c)(3)-1(b)(1)(ii) (1960). Even if the practice and intention of the organization is to conduct exclusively exempt activities, if the governing documents permit broader activities, exemption will be denied. Treas. Reg. § 1.501(c)(3)-1(b)(1)(iv). Only an insubstantial part of the organization’s activities may be other than pursuing its exempt purposes. Treas. Reg. § 1.501(c)(3)-1(b)(1)(iii) (1960).

224. Treas. Reg. § 1.501(c)(3)-1(b)(3)(i) (1960).

225. Treas. Reg. § 1.501(c)(3)-1(b)(3)(ii) (1960). Both direct and indirect participation are forbidden, as well as the publication of statements, and campaigning entails both that on behalf of and that in opposition to anyone’s election. *Id.* Charities are also forbidden from engaging in activities of an action organization. Treas. Reg. § 1.501(c)(3)-1(b)(3)(iii) (1960).

226. Treas. Reg. § 1.501(c)(3)-1(b)(4) (1960).

227. Treas. Reg. § 1.501(c)(3)-1(c)(1) (1960).

228. Strict compliance with the standard of “exclusively” would not be practicable. *See* FREMONT-SMITH, *supra* note 179, at 247.

229. Treas. Reg. § 1.501(c)(3)-1(c)(2) (1960). The operational test also entails prohibitions on functioning as an “action organization,” an entity that influences legislation. Treas. Reg. § 1.501(c)(3)-1(c)(3) (1960).

230. Recall that one requirement of a 501(c)(3) organization is that “no part of the net earnings of [the organization] inures to the benefit of any private shareholder or individual.” I.R.C. § 501(c)(3) (2010).

231. For going on a century, there have been restrictions on private inurement. *See* Corporation Tax Act of 1909, ch. 6, § 38, 36 Stat. 11, § 113 (1909).

232. *See* FREMONT-SMITH, *supra* note 179, at 248–49.

233. *See* I.R.S. Priv. Ltr. Rul. 82-34-084 (May 27, 1982).

or loans²³⁴ and excessive compensation.²³⁵ The prohibition of private inurement is “not an absolute ban on self-dealing; rather it is a standard based on reasonableness that can be substantiated by reference to the terms of an arm’s-length transaction.”²³⁶

Tax-exempt organizations are also restricted in the degree of private benefit they may provide. The Treasury Regulations explain that a nonprofit will not meet the organizational and operational tests described earlier in this section “unless it serves a public rather than a private interest.”²³⁷ A qualifying organization must demonstrate “that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.”²³⁸

The Internal Revenue Code defines several classes of charitable organizations and treats them differently.²³⁹ There are four main categories of public charities, and all charitable organizations which fail classification as one of these public charities are classified as private foundations.²⁴⁰

The first type of public charity is a publicly supported organization.²⁴¹ This group includes some institutions that are granted this status due to their category,²⁴² including churches,²⁴³ educational organizations,²⁴⁴ hospitals,²⁴⁵ state university endowment funds,²⁴⁶ and units of the government.²⁴⁷ It also includes charities that meet the support test: at least one-third of their annual support generally comes from governmental units or the general public.²⁴⁸

The second type of public charity is a services organization, which receives substantial funding from a combination of donations and fees for

234. See *Lowry Hosp. Ass’n v. Comm’r*, 66 T.C. 850 (1976).

235. See *Inc. Trs. of the Gospel Worker Soc’y v. United States*, 510 F. Supp. 374 (D.D.C. 1981), *aff’d*, 672 F.2d 894 (D.C. Cir. 1981), *cert. denied*, 456 U.S. 944 (1982); *Founding Church of Scientology v. United States*, 412 F.2d 1197 (Ct. Cl. 1969), *cert. denied*, 397 U.S. 1009 (1970).

236. *FREMONT-SMITH*, *supra* note 179, at 248.

237. Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) (1960).

238. *Id.*

239. See I.R.C. §§ 4941–4945 (2010), which applies only to private foundations.

240. I.R.C. § 509 (2010).

241. I.R.C. § 509(a)(1) (2010).

242. *Id.*; see also I.R.C. § 170(b)(1)(A) (2010).

243. See I.R.C. §§ 509(a)(1), 170(b)(1)(A)(i) (2010).

244. See I.R.C. §§ 509(a)(1), 170(b)(1)(A)(ii) (2010).

245. See I.R.C. §§ 509(a)(1), 170(b)(1)(A)(iii) (2010).

246. See *id.*

247. See I.R.C. §§ 509(a)(1), 170(b)(1)(A)(v) (2010).

248. See I.R.C. §§ 509(a)(1), 170(b)(1)(A)(iv) (2010); see also Treas. Reg. § 1.170A-9(e) (1969) (detailing how support is defined and placing limitations on how support may be derived).

exempt services or functions.²⁴⁹ Charities in this category must receive at least one-third of their public support from their exempt functions (such as through ticket sales or admission costs) combined with donations from governmental units and the general public.²⁵⁰ They may also receive less than one-third of their support from investment income.²⁵¹

Supporting organizations are the third type of public charity.²⁵² These organizations derive their exempt status from their relationship with other public charities.²⁵³ The final type of public charity is a public safety charity—an organization whose exclusive function is to test for public safety.²⁵⁴ All organizations that do not qualify as one of the above four categories of public charities are private foundations.

Private foundations are the most heavily regulated type of charitable organization under the Internal Revenue Code. They cannot engage in transactions with “disqualified persons” (those closely associated with the foundation, including substantial donors, family members, or affiliated companies).²⁵⁵ They are required to limit their holdings of any one security, which cannot exceed a certain portion of their investment portfolio.²⁵⁶ They are restricted from making “jeopardizing” investments—holdings with an unreasonable amount of risk.²⁵⁷ Finally, private foundations must meet minimum distribution requirements.²⁵⁸

249. See I.R.C. § 509(a)(2) (2010).

250. See *id.*; see Treas. Reg. § 1.509(a)-3(a) (1972) for limitations on the exempt function income any one person or entity may provide.

251. See I.R.C. § 509(a)(2) (2010).

252. See I.R.C. § 509(a)(3) (2010). For a thorough explanation of the details of the tax rules governing supporting organizations, see generally Alyssa A. DiRusso, *Supporting the Supporting Organization: The Potential and Exploitation of 509(a)(3) Charities*, 39 IND. L. REV. 207 (2006).

253. See I.R.C. § 509(a)(3) (2010), which provides that an organization is not a private foundation and is therefore classified as a supporting organization if it:

(A) is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in paragraph (1) or (2), (B) is (i) operated, supervised, or controlled by or in connection with one or more organizations described in paragraph (1) or (2) . . . , and (C) is not controlled directly or indirectly by one or more disqualified persons . . . other than foundation managers and other than one or more organizations described in paragraph (1) or (2).

254. I.R.C. § 509(a)(4) (2010). Public safety organizations are rare; an example is the American Fireworks Standards Laboratory, a nonprofit organization formed to “develop and maintain voluntary safety and quality standards” for fireworks and “provide a testing program” for whether those standards are met. See AM. FIREWORKS STANDARDS LABORATORY, <http://www.afsl.org> (last visited Jan. 21, 2011).

255. See I.R.C. § 4941 (2010).

256. See I.R.C. § 4943 (2010).

257. See I.R.C. § 4944 (2010).

258. See I.R.C. § 4942 (2010).

These rules limit the way private foundations can structure their business agreements and invest their assets.

Not only is the Internal Revenue Code the heart of American nonprofit regulation, the IRS itself has in recent years served as a substantial force of regulatory power. Federal tax penalties can be imposed on the organization (and in some cases the directors or trustees) in the event of breach of fiduciary duties.²⁵⁹ As explained earlier, charitable organizations are subject to a prohibition against private inurement.²⁶⁰

In addition, the IRS can now impose supplementary taxes when a charitable organization engages in transactions that garner “excess benefits” for its leaders or other insiders.²⁶¹ Excess benefits exist when a tax-exempt organization provides an economic benefit to an insider “if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit.”²⁶² Consequently, this section penalizes the insider and the nonprofit leaders who knowingly participated in the transaction, rather than the nonprofit itself.²⁶³

Furthermore, upon a particularly egregious breach of fiduciary duties, the IRS can revoke an organization’s tax-exempt status. Even the threat of revocation can often allow the IRS to influence the organization to change behaviors. However, because revoking a charity’s tax-exempt status “is such a drastic measure . . . the IRS uses it infrequently.”²⁶⁴ Despite its infrequent use, complete revocation of tax-exempt status is an option, and has been used in severe cases of charitable abuse.²⁶⁵

259. See I.R.C. §§ 170(c), 501(c) (2010).

260. I.R.C. §§ 170(c), 501(c)(3) (2010). Because of this requirement, “if a director, trustee or other person takes advantage of the charitable organization by taking excessive salary or by engaging in a self-dealing transaction that benefits the individual and harms the organization, the organization will fail to meet the requirements of sections 501(c)(3) and 170(c).” Gary, *supra* note 190, at 629–30.

261. See I.R.C. § 4958(a), (b). These insiders include “any person who was, at any time during the 5-year period ending on the date of such transaction, in a position to exercise substantial influence over the affairs of the organization” or a member of that person’s family. I.R.C. § 4958(f)(1)(A)–(B) (2010).

262. I.R.C. § 4958(c)(1)(A) (2010).

263. Gary, *supra* note 190, at 630. The IRS imposes a tax of 25% on the excess benefit on the insider for the first offense. I.R.C. § 4958(a) (2010). A second-tier tax of 200% is levied on the insider if it is a repeat transaction. I.R.C. § 4958(b) (2010).

264. Gary, *supra* note 190, at 630. Part of the reason why revocation is so infrequently used is that [i]f an individual director has benefited at the expense of the nonprofit organization, revoking the organization’s exempt status may be disproportionate to the offense committed. Rather than penalizing the director who benefited privately, revocation of exempt status penalizes the organization and the public interests served by the organization.

Id. (footnotes omitted).

265. The Bishop Estate provides a key example of the role of the IRS in enforcing charities law.

The Internal Revenue Code serves not just as regulation for the activities of nonprofits themselves, but as key motivator for donations to them. American tax law provides several incentives for individuals, as well as corporations, to engage in charitable giving. In allowing a reduction in tax liability for charitable contributions, Congress encourages individuals and organizations to personally support a wide range of activities that the government does not directly assist.²⁶⁶ The most common tax incentives are provided through a deduction in the taxpayer's liability for federal income taxes (including incentives for corporations) and federal transfer taxes.

The general rule is that individuals are allowed a deduction on their federal income tax return for any charitable contributions made during the taxable year.²⁶⁷ There are limitations, however, not only on which charitable contributions will qualify for a deduction, but also on the value of allowable deductions in any given year.²⁶⁸ In order for the taxpayer to take advantage of these incentives, several requirements must be met.

First, the charitable contribution must be made to a qualifying recipient.²⁶⁹ Second, the value of the charitable contributions must not

For an extensive discussion of the Bishop Estate scandal, see SAMUEL P. KING & RANDALL W. ROTH, *BROKEN TRUST: GREED, MISMANAGEMENT, AND POLITICAL MANIPULATION AT AMERICA'S LARGEST CHARITABLE TRUST* (2006). See also DUKEMINIER, *supra* note 191, at 763. In the Bishop Estate case, the IRS revoked the trust's tax-exempt status retroactively, but stated that it would restore the status if the five trustees resigned or were removed. *Id.* at 765. The IRS found "that the Estate was not being operated primarily for charitable purposes; that it had gotten directly involved in local and national political campaigns; trustee fees were grossly in excess of the value of the trustees' services; and there has been numerous instances of private benefit of trust assets." *Id.*; see also Gary, *supra* note 190, at 630 ("That threat resulted in the temporary removal of the trustees and likely influenced the decision to remove the trustees permanently." (footnote omitted)).

266. See, e.g., *Brinley v. Comm'r*, 782 F.2d 1326, 1336 (5th Cir. 1986) (Hill, J., dissenting) ("[T]he practice of making charitable contributions is a most worthy attribute of our society and should be encouraged since it aids in the accomplishment of many social goals which our federal and local governments otherwise cannot or will not accomplish . . .").

267. See I.R.C. § 170(a) (2010).

268. The Internal Revenue Code also regulates valuation of charitable deductions, and may impose tax penalties in the event a taxpayer inflates the value of a donation. See generally I.R.C. § 6662 (2010).

269. See I.R.C. § 170(c) (2010). Section 170(c) defines a charitable contribution to include a State, or any political subdivision of a State, "if the contribution or gift is made for exclusively public purposes." I.R.C. § 170(c)(1) (2010). A contribution to a corporation, trust, community chest, fund, or foundation will also qualify for a deduction if the organization is created or organized in the United States and "organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals." I.R.C. § 170(c)(2)(A), (B) (2010). In addition, any net earnings of the organization cannot benefit any private shareholder or individual. I.R.C. § 170(c)(2)(C) (2010). Moreover, the organization cannot be "disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and which does not participate in, or intervene in

exceed the annual maximum.²⁷⁰ Finally, most donations of less than the donor's full interest in the property will not qualify for a charitable contribution deduction.²⁷¹ Certain partial interests in trust do qualify for the charitable deduction if the requirements of section 170(f)(2) are followed.²⁷²

The Internal Revenue Code includes incentives for charitable giving at death as well as during life.²⁷³ Like the income tax requirements, both the estate and gift taxes place the same restrictions on the charitable contributions of partial interests in property.²⁷⁴ Unlike the income tax, no monetary or percentage limits exist to cap the allowable amount of deductions under either the gift or estate tax systems.²⁷⁵ In order for an estate to claim a charitable deduction, the decedent must designate a qualified recipient of the charitable donation.²⁷⁶ Like the qualifications for

(including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office." I.R.C. § 170(c)(2)(D) (2010). Contributions given directly to individuals will not qualify for a deduction. Moreover, the donor cannot benefit directly from the contribution made to the qualifying recipient. *Ottawa Silica Co v. United States*, 699 F.2d 1124, 1131 (Fed. Cir. 1983); *see also* *Comm'r v. Duberstein*, 363 U.S. 278, 285 (1960) ("[T]he most critical consideration . . . is the [donor]'s intention.").

270. I.R.C. § 170(b)(1)(B) (2010). These caps prevent taxpayers from completely avoiding the payment of federal income tax by giving all of their income to a qualifying charity. *See generally* J. MARTIN BURKE & MICHAEL K. FRIEL, *TAXATION OF INDIVIDUAL INCOME* 579 (8th ed. 2007). These limitations place a cap on the amount allowed as a deduction; the amount allowed as a deduction cannot exceed 50% of the individual's "contribution base," which is generally the taxpayer's adjusted gross income. *See* I.R.C. § 170(b)(1)(F) (2010). The amount of the cap depends on the nature of the property contributed and the nature of the charitable organization that receives the donation. For most charitable contributions, the amount allowed as a deduction cannot exceed 50% of the taxpayer's contribution base. I.R.C. § 170(b)(1)(A) (2010). Caps imposed on capital gain property, as well as contributions to organization not listed in section 170(b)(1)(A), are limited to 20% or 30% of a taxpayer's contribution base. I.R.C. § 170(b)(1)(C), (D)(i) (2010).

271. I.R.C. § 170(f)(3)(A) (2010).

272. I.R.C. § 170(f)(2) (2010). A charitable contribution of the remainder interest will qualify for a deduction if "the trust is a charitable remainder annuity trust, or a charitable remainder unitrust, or . . . a pooled income fund . . ." I.R.C. § 170(f)(2)(A) (2010). *See also* John G. Steinkamp, *Decoding Estate Planning: A Review of Frequently Used Acronyms*, 2001 ARK. L. NOTES 73, 74–76 (providing a general overview of charitable remainder annuity trust ("CRAT") and charitable remainder unitrust ("CRUT")). A charitable contribution of the income interest will qualify for a deduction if the interest "is in the form of a guaranteed annuity or the trust instrument specifies that the interest is a fixed percentage distributed yearly of the fair market value of the trust property (to be determined yearly) and the grantor is treated as the owner of such interest . . ." I.R.C. § 170(f)(2)(B) (2010). *See also* Steinkamp, *supra* note 272, at 73–74 (providing a general overview of charitable lead annuity trust ("CLAT") and charitable lead unitrust ("CLUT")).

273. *See generally* I.R.C. §§ 2522, 2055 (2010).

274. I.R.C. §§ 2522(c)(2), 2055(e)(2) (2010).

275. However, the deduction cannot exceed the value of the property. I.R.C. §§ 2055(d), 2522(a) (2010).

276. *See* *Estate of Pickard v. Comm'r*, 60 T.C. 618 (1973).

a deduction under the income tax structure, only those organizations which are listed in section 2055(a) will be a qualified recipient.²⁷⁷

Corporations are also allowed to take advantage of lowering their tax liability by making charitable contributions. Section 170(c)(2) provides that charitable contributions by a corporation can only be to those charitable organizations that operate “exclusively for religious, charitable, scientific, literary, or educational purposes, to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals.”²⁷⁸ Therefore, corporations cannot receive a deduction for charitable donations made to a state or a political subdivision of a state.²⁷⁹ The amount of deductions allowed for corporations cannot exceed 10% of the total amount of the corporation’s taxable income.²⁸⁰

Federal bankruptcy law plays a small supportive role in the regulation of nonprofits. Although it directly regulates only insolvent entities, elements of bankruptcy law support charitable giving. The Bankruptcy Code includes favorable treatment for transfers to charitable organizations, excluding such donations from a debtor’s “disposable income,” from constituting fraudulent conveyances, or from being taken into account in a court’s decision to dismiss or convert a bankruptcy case.²⁸¹ Underpinning

277. Qualifying organizations include charitable contributions made:

(1) to or for the use of the United States, any State, any political subdivision thereof, or the District of Columbia, for exclusively public purposes;

(2) to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), and the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, which is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office;

I.R.C. § 2055(a) (2010). Qualifying organizations also include donations to a lodge system, but only if the lodge system meets the same requirements as corporations must under section 2055(a)(2). I.R.C. § 2055(a)(3) (2010). In addition, contributions made to many veterans’ organizations will qualify for an estate tax deduction, as well as some employee stock ownership plans. I.R.C. § 2055(a)(4)-(5) (2010).

278. I.R.C. § 170(c)(2) (2010).

279. *Id.*

280. I.R.C. § 170(b)(2)(A) (2010). The corporation’s taxable income is determined without regard to its charitable contributions. I.R.C. § 170(b)(2)(C) (2010).

281. See 11 U.S.C. § 1325(b)(2)(A)(ii) (2010), which allows charitable contributions to a qualified religious or charitable entity or organization, up to 15% of a debtor’s gross income, to be excluded from “disposable income” for bankruptcy purposes. See also 11 U.S.C. § 548(a)(2) (2010), which provides charitable contributions to a qualified religious or charitable entity or organization, up to certain limitations, are not considered fraudulent transfers for bankruptcy purposes. See also 11

this special treatment for charities is a dedication to respecting the religious motivations of their donors.²⁸²

The majority of federal law that affects nonprofits, however, remains tax law. There is no central regulator for the administration of charitable activities, and the incentives of the Internal Revenue Code effectively serve as primary motivator for appropriate nonprofit behavior. American nonprofit regulation seeks to moderate the relationship between the third sector and its donors and leaders, and does so primarily through federal tax law.

IV. COMPARATIVE NONPROFIT REGULATION AND THE AMERICAN MODEL

A. Overview

The lens of comparative law brings the distinctive features of the American approach into a clearer focus. Aspects of the third sector that many Americans may take for granted are by no means universal and, in fact, are minority approaches.

The following discussion will address two specific observations about how U.S. nonprofit law is distinctive from its European and Asian counterparts, and explain how these unique features may be interdependent. First, the primary focus of legal regulation in the United States is the relationship between the nonprofit and its donors or leaders, where the primary focus of most foreign regulation is the relationship between the nonprofit and the state. Second, and in a manner that could perhaps be related, U.S. law is unusually tax-centric.

B. *The Relational Focus of American Nonprofit Law*

A distinctive feature of the U.S. third sector is the central focus of its governmental regulation: the relationship between the nonprofit and its leaders and donors. Although a primary feature of regulation in most other countries, the relationship between the nonprofit and the government is

U.S.C. § 707(b) (2010), which provides that the court may dismiss or convert bankruptcy cases, if granting bankruptcy relief would be an abuse of the provisions of the Code, but establishing a special rule for charitable contributions: “In making a determination whether to dismiss a case . . . the court may not take into consideration whether a debtor has made, or continues to make, charitable contributions . . . to any qualified religious or charitable entity or organization . . .”

282. See *In re Young*, 141 F.3d 854 (8th Cir. 1998), *cert. denied*, 525 U.S. 811 (1998), in which the court discussed the application of The Religious Freedom Restoration Act (“RFRA”), 42 U.S.C. § 2000bb et seq., and held that allowing a bankruptcy trustee to recover tithes to a church would substantially burden a debtor’s free exercise of religion.

minimally regulated in the United States and not a central focus of nonprofit law.

Recall that the American system of nonprofit regulation exists at both the federal and state levels. At neither level is the primary focus of regulation the division of power and control between the first and third sectors. Neither state nor federal law plays a significant gate-keeping function that would allow government to control the authority and power of the third sector.

States are interested in regulating the relationship between nonprofits and donors. States generally require preregistration for nonprofits that will be soliciting citizens for funds and will bring actions against charities that use fraud or misrepresentation to entice citizens into donations.²⁸³ Notably, state regulation of nonprofit activities is often organized through a state's Consumer Protection Division.²⁸⁴

States also allocate resources to regulating the relationship between the nonprofit and its leaders and beneficiaries. The state Attorney General may intervene if a charitable trustee or other leader has breached a fiduciary duty, and serves as the official protector of the charitable interests of such organizations. Charitable beneficiaries expressly named in the trust or other organizational documents may use the power of the state (through the Attorney General) to insure compliance with the terms of the documents and fiduciary law.

State nonprofit law plays no substantial gate-keeping role and has only modest elements that reflect the relationship between the nonprofit and state. Organizing a charitable trust in a state takes no state governmental intervention at all.²⁸⁵ Organizing a charitable corporation takes only minimal filing paperwork, and the state has no regulatory discretion to accept or deny incorporation papers, as long as the forms are completed appropriately. Although state law may have language that one might expect could allow discretion, for example requiring a "charitable purpose" for nonprofit incorporation, an organization may merely recite that it meets the requirements under state law and will be successfully incorporated.

One small element of state law that acknowledges the relationship between the three sectors relates to tax law. Through state property tax

283. See NAT'L ASS'N OF STATE CHARITABLE OFFICIALS, *supra* note 201.

284. *See id.*

285. Some states will require that certain charitable trusts, such as those that establish public charities, file a copy of their documents with the state; this filing requirement, however, does not prevent the organization from existing or operating.

exemptions, and the value of these exemptions, states can exert some influence on a nonprofit's decision to operate in a state.²⁸⁶ These same property tax exemptions serve as a mild regulatory force on the relationship between the third and second sectors—nonprofits will forfeit tax exemptions if their real estate is used for substantial business activity.

The second small element of the interrelationship between state and third sector relates to funding grants. Many nonprofit organizations, although by no means all, are dependent upon state grants for funding support. A state can demonstrate its commitment to supporting a nonprofit organization by awarding it funds, or its disapproval by withdrawing them. While state funding is not essential to the survival of many nonprofits, its absence does require additional fundraising from private donors or fees from charitable activities.²⁸⁷ Many nonprofits that receive no funding from the state compete ably with those that do (private with state universities, for example).

Like state nonprofit law, federal nonprofit law has little appetite for regulating the relationship between government and charity. One small aspect of regulatory power that the American federal government exercises is through selective grant-making. Entities such as the National Endowment for the Arts can, through the power of the dollar, influence the activities of certain nonprofits. Organizations that rely upon the American government for direct financial grants, however, represent the minority of nonprofits.

As discussed in the next section, federal nonprofit law regulates almost exclusively through tax law. The majority of tax laws operate to regulate the relationship between the organization and its donors and leaders. There are a few elements of federal tax law that address the balance between government and nonprofit, but they primarily address their separation rather than an allocation of power between them. Charitable organizations are essentially required to refrain from directly intervening in a political campaign.²⁸⁸ They are also limited in the amount of money they can spend on lobbying activities.²⁸⁹

286. An example is that of a nonprofit hospital or university; an attractive property tax exemption might motivate an organization to select or avoid a state for incorporation.

287. See Michael Kimmelman, *In Europe, The Arts Ask for Alms*, N.Y. TIMES, Jan. 20, 2010, at C1 (noting that “American museum directors these days must spend their careers passing the tin cup, but by now government grants in the United States, which were always small, are beholden to special interests and awarded to recipients who will offend neither left nor right—so they offer no real alternative”).

288. See I.R.C. § 501(c)(3) (2010).

289. See I.R.C. § 509 (2010).

American federal tax law briefly addresses the relationship between the third sector and the second sector, primarily by eliminating the tax benefit for business activities of nonprofits. Charitable organizations that generate income based on business activities that are not related to their exempt purpose will be subject to tax on that income.²⁹⁰ Likewise, nonprofits will not qualify to be tax-exempt if their purpose is business rather than “charitable.”²⁹¹ These rules help define the boundary lines between the third and second sectors, but the only penalty for crossing them is tax parity rather than tax advantage.

I have argued that the central focus of American nonprofit law is the regulation of the relationship between the nonprofit and its donors and leaders. By contrast, I believe the central focus of the law of most other countries is the relationship between the nonprofit and the government.

Regulating the balance of power between the first and third sectors is a primary emphasis in European and Asian countries alike. Although it is fair to say that all countries to some degree must confront both issues of the nonprofit-state relationship and the nonprofit-leader/donor relationship, it does appear that America is unique in its lack of dedication to the third sector/first sector balance as a primary concern. Perhaps there is more overlap between the roles played by government and the third sector in Europe and Asia than in America, particularly with respect to social services. Whatever the reason, America’s rather nonchalant attitude toward the state/nonprofit dynamic is striking.

Sweden provides an excellent foil to the United States. Sweden’s regulatory system and approach to the third sector demonstrates a commitment to carefully negotiating the balance between state and nonprofit.²⁹² Swedish society has deliberately shifted the provision of many services (now considered “rights”) from the third sector to the first.²⁹³ The remaining activities of the third sector often focus on the first sector: nonprofits provide coordinated participation in governmental policy making, lobby, and even engage directly with the drafting or application of laws.²⁹⁴ The dynamics of the relationship between the third sector and the state are central.

290. See I.R.C. § 512 (2010).

291. See I.R.C. § 501(c)(3) (2010).

292. Pestoff, *supra* note 93, at 63–82.

293. *Id.* at 71.

294. *Id.* at 80.

France, distinctive from Sweden in so many ways, shares its commitment to regulating the balance between nonprofit and state.²⁹⁵ The state interest in regulating nonprofits is evident from the recent change in governmental structure: the creation of a State Secretary for the Civil and Solidarity-based Economy.²⁹⁶ There is a high degree of governmental regulation, and most nonprofits rely on the state and not individual donors for financial support.²⁹⁷ France also uses its state regulatory influence over the third sector to affect the second sector; the goals of association, self-organization, and solidarity are supported to offset potential inequities of the market.²⁹⁸ France remains cognizant of its historical mistrust of nonprofits, and dedicated to protecting against interference with the relationship between the government and the people.²⁹⁹

Italy, too, has a history of questioning whether intermediaries like nonprofits would “obstruc[t] the direct relationship between the state and the citizen.”³⁰⁰ Although the informal and flexible association and cooperative forms currently flourish in Italy,³⁰¹ this is a fairly recent development and a deliberative choice to shift the balance of power between state and nonprofit. It is also notable that Italian law does not insist upon the non-distribution restraint that is central to American federal regulation, a notion that focuses on the relationship between the nonprofit and its donors and leaders rather than the relationship with the state.³⁰²

Germany also has a primary focus on the balance between the sectors and a unique approach to negotiating them.³⁰³ As discussed above, German nonprofits function more as an “intermediary sphere” than a “third sector.”³⁰⁴ It is notable that the role of cooperative nonprofits faded when the German government absorbed greater responsibility for welfare and economic reform;³⁰⁵ this is an example of the shift of regulatory power among the sectors.

Asian countries as well, although distinctive from the European third sector in many ways, share the central focus of regulating the state/nonprofit relationship.

295. On the French third sector generally, see Chaniel & Laville, *supra* note 21, at 83–99.

296. *Id.* at 96–97.

297. *Id.* at 91.

298. *Id.* at 83–84.

299. *Id.* at 84–88.

300. Borzaga, *supra* note 65, at 49.

301. *Id.* at 55.

302. *Id.* at 61 n.6 (citations omitted).

303. Bode & Evers, *supra* note 45, at 101–21.

304. *Id.* at 101.

305. *Id.* at 106.

India has strong reins on its nonprofit sector and substantial regulatory force attributed to managing the balance of power between the first sector and the third. Voluntary associations are required to register at both the federal and local levels, with government officials granted significant discretion in granting or withholding approval. The FCRA grants significant additional authority to the government in determining the existence and operation of nonprofits that depend on foreign funds, which is the vast majority.³⁰⁶

Even Bangladesh, with its relatively young and fragile third sector, actively confronts the balance of power between the sectors. Nonprofit societies must register with the state under the Societies Registration Act, and must be granted a license by the government in order to operate. Recently, Bangladesh addressed the rights of nonprofits to engage in commercial activities—empowering the nonprofits, in part, because of a desire to promote national ideals and priorities of the first sector by minimizing reliance on contributions from foreign donors.³⁰⁷

Nepal, Sri Lanka, and Pakistan are consistent in their regulatory priority of moderating how power is shared between the first sector and the third. Recall that the Nepalese government retains a right to terminate nonprofits, commandeering their assets.³⁰⁸ The Sri Lankan government also retains broad authority to terminate, take over, or dissolve nonprofits on a wide variety of discretionary grounds.³⁰⁹ Pakistan wields similar control to exercise management takeover rights.³¹⁰

The relative unimportance in American law of the balance of control between nonprofits and government is remarkable when compared to the centrality of this issue throughout Europe and Asia. This distinctive relational focus is perhaps why the United States regulates nonprofits almost exclusively through tax law; additional sources of regulation to serve a stronger gate-keeping function are not necessary.

C. The Tax-Centrism of American Nonprofit Law

American nonprofit law is predominantly tax law. The U.S. government exerts power over its third sector almost exclusively through

306. The Foreign Contribution (Regulation) Act, No. 49 of 1976, INDIA CODE (2003), available at <http://www.accountaid.net>.

307. See Sidel, *supra* note 107, at 1643.

308. *Key Themes and Key Choices*, *supra* note 139, at 47 (citing Sinha & Malla, *supra* note 139, at 214).

309. *Id.* (citing Wikramanayake, *supra* note 139, at 351).

310. *Id.* (citing Ismail & Baig, *supra* note 139, at 322).

the Treasury. Although the government grants valuable tax exemptions to entice nonprofit activity (and tax incentives for individual and corporate funders to donate to charities), the tax system does little more than encourage nonprofit activity and deter substantial abuses.

The tax system in America functions primarily to (1) protect against abuses that affect the relationship between the nonprofit and its donors or leaders, and (2) encourage philanthropic gifts. It is perhaps clearest to treat these functions in turn.

Tax law in the United States has a primary focus of regulating the relationship between the nonprofit and its donors and leaders, and assuring that the benefits of tax-exempt status are not being usurped by a second-sector entity. This regulation takes the form of requirements to maintain exemption from federal income tax by a nonprofit organization. It works primarily to regulate the activities of existing charities, and does not play a significant gate-keeping role that bars or regulates entry into the third sector. Although tax law sets out the requirement of what constitutes a charitable or tax-exempt purpose, the standards for exemption are reasonably straightforward and leave little room for administrative discretion in determining whether a nonprofit meets the criteria.³¹¹ The process for obtaining exemption from federal tax is telling: nonprofits apply for *recognition* of tax-exempt status, rather than tax-exempt status itself (the understanding being that their identity entitles them to favorable tax treatment, and the application merely demonstrates the facts underlying this entitlement).³¹² If the IRS concludes that an application does not demonstrate entitlement to tax-exempt status, that decision is judicially reviewable; the agency does not have unfettered discretion to determine what qualifies as an appropriate addition to the third sector.

Although federal tax law does not function as a barrier to entry, it does function as a deterrent against abuse. Nonprofits can lose their tax-exempt status—a valuable commodity—if they operate in a manner that funnels profits to insiders or private citizens rather than the charitable class they were formed to support. They can also suffer penalty taxes for engaging in certain inappropriate transactions with insiders (“excess benefit transactions”) that shift charitable assets to private parties in the form of

311. It could be argued that the United States has some mild authority to affect public policy concerns through its conception of what constitutes “charitable” activity; whether racially restrictive scholarship grants are permissible is one example. *See, e.g., Bob Jones Univ. v. United States*, 461 U.S. 574, 592 (1983) (holding it appropriate to deny tax-exempt status to a school whose racial discrimination policies were inconsistent with public policy and justice concerns).

312. The application for recognition of tax-exempt status is submitted on Form 1023, available at <http://www.irs.gov/pub/irs-pdf/f1023.pdf> (last visited Jan. 21, 2011).

unreasonable compensation, loans, or similar transfers. Private foundations are regulated by an additional bevy of rules that protect against mismanagement of investments, hoarding of assets, and inappropriate expenditures. Tax law is arguably the most efficient tool used in America for minimizing abuses in the third sector.

The secondary function of tax law in America is to motivate charitable giving. Tax provisions at multiple levels (income tax and estate tax, for example) provide financial incentives for wealthy individual taxpayers to make donations to nonprofit organizations. Tax law offers some benefits for choosing certain types of nonprofits over others—gifts to public charities offer more attractive valuation rules and are subject to more generous caps on how much can be deducted—but tax law expresses no priorities among various classes of nonprofits. The government does not, for example, motivate charitable contributions to health care organizations by offering a larger deduction for gifts to hospitals than for gifts to universities or the local belly-dance performance troupe.

It is surprising and not terribly well-justified that tax law is central to American nonprofits.³¹³ Why should the central regulatory force be the Treasury? The primary purpose of tax law is ostensibly raising revenue; surely that is not the primary function here, as much revenue is forgone. The main reasons for using the Treasury as regulatory center seems to be that money talks, and that the system (largely) works. On a structural level, though, housing national oversight of the third sector in the Treasury is counterintuitive.

313. The comparative analysis of this Article lends support to the argument that exclusive regulation by the Treasury is questionable. Commentators have criticized this source of regulation and argued for reform. See, e.g., Marion R. Fremont-Smith, *The Search for Greater Accountability of Nonprofit Organizations: Recent Legal Developments and Proposals for Change*, 76 *FORDHAM L. REV.* 609, 641, which notes that:

The role of the IRS as regulator of tax-exempt entities has long been subject to question by commentators, government officials, and practitioners. Proposals to create a new agency to regulate charities, some modeled on the English Charity Commissioners, some on the Securities and Exchange Commission or the quasi-governmental bodies which operate in conjunction with it, have been considered.

Suggestions for reform include modest proposals to increase funding to more dramatic change in the locus of regulation and enforcement. *Id.* One former director of the IRS Exempt Organizations Division advocated the latter kind of change:

[He] suggested moving enforcement to a new agency modeled on the National Association of Securities Dealers This would be a quasi-public agency, financed in part by credits against the excise tax on private foundations or a licensing fee, operating in conjunction with the IRS as the National Association of Securities Dealers does, with the new body granting exemptions and receiving and reviewing annual reports.

Id. (citations omitted).

Few other countries share America's commitment to tax as the center of nonprofit law. In some countries, tax plays no role at all. In those where it does, tax is rarely the central regulating force or source of federal authority.

A more balanced approach is illustrated by Bangladesh. Tax does play a role in the law of nonprofits there, and the importance of tax benefits is perhaps growing. It is notable, however, that tax law in Bangladesh involves a level of discretionary decision-making that American tax law does not.³¹⁴ Bangladesh also has a system of licenses that must be granted by governmental authorities for a nonprofit to conduct activities. Bangladesh therefore has an additional resource to exercise the gate-keeping function that tax law does not appear sufficient to offer.

India, likewise, adopts a model where tax is more supporting actress than leading lady. True, nonprofit organizations are exempt from certain federal taxes, and individuals receive incentives in the form of deductions to make charitable gifts.³¹⁵ The primary source of regulatory authority, however, rests in the Ministry of Home Affairs, with the granting of licenses at various levels of government, and through the FCRA.

Countries in Europe, likewise, often integrate tax only as a minor aspect of their nonprofit regulatory scheme. Tax is clearly not the backbone of the law of the third sector in Sweden; there is no income tax incentive for charitable contributions.³¹⁶ Italy's modest tax benefits that encourage philanthropic institutions and their donors are neither central to the government's regulatory force nor significant.³¹⁷ France has allowed charitable income tax deductions for donations to nonprofits only recently,³¹⁸ tax is hardly the center of its regulatory scheme. Germany follows suit, offering some tax incentives for charity,³¹⁹ but exerting other regulatory force—including the reliance upon the government for nonprofit funding—rather than bare reliance upon tax law.³²⁰

314. ASIA PAC. PHILANTHROPY CONSORTIUM, PHILANTHROPY AND LAW IN SOUTH ASIA—RECENT DEVELOPMENTS IN BANGLADESH, INDIA, NEPAL, PAKISTAN AND SRI LANKA 15 (Sept. 2007).

315. The Income Tax Act, No. 43 of 1961, *amended by* Finance Act, No. 32 of 2003 INDIA CODE (2003); *see also* Sidel, *supra* note 107, at 1619.

316. Benschalom, *supra* note 100.

317. Borzaga, *supra* note 65, at 46, 54.

318. ARCHAMBAULT, *supra* note 40, at 69.

319. Germany allows for exemption from tax for nonprofits as well as charitable deductions for donors. COUNCIL ON FOUNDATIONS, U.S. INTERNATIONAL GRANTMAKING—GERMANY, *supra* note 52, at 8–9.

320. *See supra* note 58 and accompanying text.

European law, however, may become increasingly “Americanized” when it comes to tax incentives for charities.³²¹ A recent article in the *New York Times* discussed the increased willingness of governments in Germany, France, Italy, and Great Britain to use tax incentives to shift the funding of nonprofits from the state to private donors.³²² These decisions are made with acknowledgement of the release of regulatory power such a shift would entail:

Didier Alaïme, who represents the Confédération Générale du Travail, the country’s biggest union, in its dealings with the Culture Ministry, said the other day that “the more public policies are dependent on private financing, the more they risk feeling the ups and downs of the market.” He added, “The more we’re dependent on outside financing, the less we”—he was speaking about the people of France—“control the policies that are financed.”³²³

Should the law in Europe migrate toward an American tax-centrism? A nonprofit regulatory regime that centers on tax is consistent with a laissez-faire approach to managing the balance of power between the third sector and the state; this perspective does not seem consistent with the historical treatment of nonprofits in Europe.

V. CONCLUSION: IMPROVING AMERICAN NONPROFIT LAW THROUGH COMPARATIVE LAW INSIGHTS

The vibrancy of the third sector in Europe and Asia is a gentle reminder that the American way is not the only way. There is much in the American system of nonprofit regulation that we take for granted; we ought to question more. The comparative analysis of this Article highlights the idiosyncrasies of the American approach; we should now determine whether these distinctive features serve us well. The current wave of interest in nonprofit law as a distinct area of study offers a unique opportunity to improve the American third sector. Nonprofit law may operate in a silo, as too many areas of law do, or may benefit from the broader view that an international and interdisciplinary approach can offer.

Although countries in South Asia are in many ways struggling with their philanthropic identity, they have some advantages over—or at least lessons for—the United States. Perhaps the greatest advantage South

321. See Kimmelman, *supra* note 287.

322. See *id.*

323. *Id.*

Asian nonprofit law has over the American approach is its self-consciousness. As developing countries, India, Bangladesh, Pakistan, Nepal, and Sri Lanka give greater deliberative attention to the choices they make in the governance of the third sector. Because of their awareness of the growth and development of the nonprofit sector, these countries seem more attuned to the big-picture issues: the balance of power between charity and state; the tension between wanting third-sector solutions and maintaining governmental controls; the roles society wants and expects the third sector, as opposed to the government, to play; and the proper balance between enabling and encouraging philanthropy and regulating and controlling it (both to limit abuses and to maintain political objectives). It stands to reason that countries that consciously address these challenges will resolve them more efficiently than ones that assume the answers are already resolved.

Europe, likewise, offers lessons for the U.S. third sector. The rich civil histories of France, Germany, and Italy contribute to their dedication to respecting the relationship between citizen and state, and guarding against interference, even from nonprofits. The perspective of Sweden, which focuses on the rights of individuals rather than the beneficence of donors, is also illuminating. The balance of power between the first and third sectors, and the role of each in responding to citizens' needs, is carefully negotiated.

The unique relational focus of American law raises questions as to how deliberately we have determined the balance of power between the three sectors. What should the relative weight of the voluntary sector be, compared to the government and market sectors? Does American government retain any interest in influencing this balance, or should society (or the market?) determine the balance itself? Ought there be barriers to entry, exercised by the government, for nonprofit associations? Or is the proper focus of nonprofit law the relationship between the nonprofit and its donors and leaders, such that the relationship to the state is appropriately only an afterthought?

The tax-centric nature of American philanthropy law raises additional concerns. Is it justified to regulate nonprofits (almost) exclusively through the Treasury?³²⁴ What stake has the Treasury in the voluntary sector, as opposed to other agencies of federal government? Should state or federal government create additional avenues for regulation?

324. See Fremont-Smith, *supra* note 313, at 641.

This Article has not taken on the heavy burden of answering these questions, but seeks only to demonstrate how the current status of American nonprofit law suggests that we ask them. Perhaps the greatest lesson that comparative law affords is the insight that there can be many different, good solutions to the same problems. Greater deliberative attention to the choices American law makes with respect to the third sector will enhance its ability to serve the role we want in our society. We have perhaps taken too much for granted, and should not be afraid to question.

In comparative perspective, American nonprofit law exhibits much peculiarity. Perhaps these idiosyncrasies are not only defensible but integral to our distinctive approach to the third sector. Nonetheless, consideration of the myriad international solutions to nonprofit regulation should be undertaken with humility and respect. A comparative perspective may enhance not only our understanding of the American system of nonprofit regulation, but openness to its continued improvement.