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FIVE THREATS TO PHILANTHROPIC FREEDOM IN THESE RECESSIONARY TIMES

by
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The generosity of individual Americans is the envy of the world. No developed country even comes close to the amount of time that Americans volunteer or the amount of money Americans give to charity. Within eight days of Hurricane Katrina, Americans had donated over $580 million to relief efforts; within fifteen days of the earthquake in Haiti, $528 million.[1] Collectively, Americans gave over $308 billion to charity in the recessionary year of 2008. We are uniquely, even congenitally, generous. When it comes to philanthropy, something has gone gloriously right in the United States.

Yet one would hardly know this from the litany of grievances and regulatory proposals now emanating from activists, politicians, and philanthropic bureaucrats. Recent years have yielded bumper crops of reports, legislative efforts, and pleas calling for greater oversight, transparency, and governance of America's independent charitable sector. In different times, these complaints might be brushed aside as the perennial chatter of self-proclaimed and self-serving advocacy groups. However, as the effects of the recession linger—widespread unemployment, soaring deficits, budget shortfalls, and popular dissatisfaction with elite institutions—long-held grievances against private philanthropy may find a more receptive ear, especially given Washington's reform-minded political ethos.

From the proposed decrease in the charitable tax deduction to greater government intrusion into the operation of private foundations, there are numerous ways in which philanthropic freedom is now in jeopardy. In particular, five ideas and trends threaten to undermine America's status as the most generous country in the world.

1. ***Regulating Philanthropy through Identity Politics***. Last March, the National Committee on Responsive Philanthropy (NCRP), a national advocacy group, issued a report giving benchmarks for assessing private foundation performance. The report counsels foundations to provide, among other things, "at least 50 percent of its grant dollars to benefit lower-income communities, communities of color and other marginalized groups." A foundation should also give "25 percent of its grant dollars for advocacy, organizing and civic engagement to promote equity, opportunity and justice within our society." While the NCRP prescriptions are voluntary, the report warns that more government regulation will come if foundations "don't do a better job of regulating themselves . . . and if more grantmakers don't demonstrate their relevance to nonprofits and marginalized communities by meeting the benchmarks set forth in this document."[2]

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[1] *Donations to Help Haiti Exceed $528-million, Chronicle Tally Finds*, CHRON. OF PHILANTHROPY, Jan. 27, 2008.

[2] *Criteria for Philanthropy at Its Best: Benchmarks to Assess and Enhance Grantmaker Impact*. National Committee for

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The NCRP report came on the heels of a much-publicized effort by a Bay-Area advocacy group named Greenlining to use the threat of legislation to dictate the activities of private foundations. Greenlining sought to pass state legislation that would have required foundations to report the percentage of their grants that go to "minority-led" groups. The proposed legislation (AB 624) also mandated that foundations report the percentage of their boards and staffs made up by racial and ethnic minorities. When a handful of the state's largest foundations agreed to support Greenlining-backed charitable organizations with $30 million in grants, the legislation was dropped and Greenlining backed down . . . sort of. The organization's director, Orson Aguilar, quipped after the settlement: "that's a good start but the money isn't a substitute for legislation."

Using the threat of legislation to bend private foundations to activists' wills may turn out to be more successful than actual legislation in the present economic and political climate. That is because the court of public opinion may provide a better venue for radicals' grievances than the legislatures or courts—especially since the two principal claims of NCRP and Greenlining are so obviously false and contrary to law.

NCRP and Greenlining both claim that minority interests are better served by philanthropy when giving is directed and received by minorities, as though the benefits of privately funded cancer research, disaster relief, or higher education accrue only to Caucasians. Everyone, regardless of race or ethnicity, derives public goods from grants made by private foundations to America's civil society institutions. Indeed, The Philanthropic Collaborative recently found that more than "two out of every three dollars of all health grants made by foundations benefit low-income and minority communities."[3] Private philanthropy is one area of American society that, without heavy-handed government mandates directing grants, can make a reasonable claim to being colorblind.

NCRP and Greenlining also falsely claim that because gifts to foundations are tax-advantaged, the government and the public ought to have a say in directing where the money goes. According to this argument, the government should also decide how individuals spend their tax-advantaged retirement savings. Or perhaps the mortgage-interest deduction entitles the government to dictate what a person does inside his or her home?

The notion that individual donors and foundations, not government, legitimately determine the scope and nature of their giving is well-established law. As Evelyn Brody and John Tyler conclude in their excellent monograph *How Public Is Private Philanthropy*, "based on four centuries of law and policy, foundations and other charities are not inherently public bodies and their assets are not 'public money.'"[4] The excellence of American philanthropy derives precisely from the fact that individuals can choose freely for themselves the causes, ideas, and organizations they wish to support or not to support. As Naomi Shaefer Riley has put it, "The distinctive characteristic of American philanthropy is *freedom*."[5] NCRP and Greenlining would turn this on its head by dictating the terms of private giving.

With research support from NCRP, Greenlining is now turning to other states—including Florida, New York, and Pennsylvania—to push their notion that private foundations should conduct their business based upon a narrowly construed set of racial and ethnic criteria, and that state governments ought to pass laws to enforce this idea. Will a prolonged economic downturn provide more fertile ground for their arguments? Aaron Dorfman, executive director of the NCRP, is counting on it. Referring to the present economic malaise, Dorfman writes: "A crisis of this level compels us to consider new, sometimes radical, solutions."

2. *Reducing or Eliminating Tax-Advantaged Giving to Private Foundations*. With the estate tax having expired at the end of 2009 and with the prospect of it automatically renewing at the end of 2010 at 55 percent with a $1 million exemption, Congress may look to private philanthropy to find offsets. *CongressDaily* reported in February 2010 that "Senate aides are quietly exploring ways to tax the massive wealth tucked away in charitable foundations, which backers say could serve the twin goals of raising revenue for an estate tax solution and triggering overdue reforms in the nonprofit sector."[6] Reducing or eliminating altogether the deduction on assets placed into private foundations could provide part of the solution. Family foundations administered by their

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Responsive Philanthropy (2009).

[3] *Broad Benefits: Health-Related Giving by Private and Community Foundations*, The Philanthropic Collaborative (2009).

[4] *How Public Is Private Philanthropy?: Separating Myth from Reality*, Philanthropy Roundtable (2009).

[5] *American Philanthropic Diversity: What It Means, Why It Matters*, Philanthropy Roundtable (2009).

[6] *Charitable Foundations Eyed as Key to Estate Tax Fix*, CONGRESSDAILY, Feb. 25, 2010.

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founders' heirs and funded by contributions that avoid the estate tax may also be a target. Likewise, eliminating the deduction on donations to "charities that are created by wills or trusts at death" may be an attractive estate-tax alternative.[7]

From an economic point of view, penalizing individuals for contributing to foundations by assessing new taxes on their giving is exceptionally shortsighted. The Philanthropic Collaborative released a report in 2008 by former Clinton administration economic official Robert Shapiro showing that for every $1 foundations spend, $8 is generated in local and national economic benefits.[8] Yet reducing the deduction on contributions to private foundations has been a perennial aspiration for those who view private foundation assets as a source of public lucre. The populist political climate, soaring deficits, and a continued economic slump could cast tax-advantaged philanthropic contributions as elitist and self-serving, giving mainstream appeal to what has been a fringe view of private philanthropy.

3. *Reducing the Charitable Deduction*. President Obama's proposal to reduce the charitable tax deduction on upper incomes in his fiscal year 2011 budget may be viewed in a similar way: a historically marginal idea that could garner popular appeal given the present mood. After first proposing the reduction in 2009 to help fund his anticipated health-care reform package, the president's plan died under withering criticism. Many complained that the president's proposal was tantamount to kicking the charitable sector when it was already down, thanks to a reeling economy. United Jewish Communities called the proposal a "disaster."[9] The Indiana University Center on Philanthropy estimated that the proposed reduction would have resulted in a loss of $3.9 billion in charitable donations.[10]

While some commentators called the President's latest proposal "dead on arrival," it could gain broad appeal in part because it would fund federal deficit reduction rather than health care. Furthermore, it is included in a package of upper-income tax provisions that target high-income earners and is broadly viewed as repealing the Reagan tax cuts. Cast in this light, the president's proposal will likely be promoted as one step in correcting widely perceived "inequalities between the rich and poor."[11] "What it would do is it would equalize," the President retorted during a news conference in 2009. "Equalizing" may strike a popular chord as the effects of the recession linger and the federal deficit soars. Yet reducing the charitable deduction would likely shrink private contributions to the nonprofit sector.

4. *Searching for Cash in the States*. The federal government is not the only entity that may be looking to philanthropy and the nonprofit sector as a potential source of found revenue during this economic downturn. State governments also pose a threat to philanthropic freedom. The depth of the fiscal crisis in some states is exemplified in a recent independent study that shows hidden shortfalls of more than half a trillion dollars in California's three principal pension funds.[12] Other cities and states are facing similar pension issues, in addition to dramatic budgetary shortfalls, and they have been dealing with them in creative ways. In Pittsburgh, for example, an ordinance was introduced by the mayor to tax tuition at colleges and universities located within the city to help pay public-employee retirement benefits. Withdrawing the property-tax exemption that most nonprofit organizations receive is under review in other cities and states around the country. Will the search for cash at the state level extend to private philanthropy?

That may seem unlikely. Yet some states have already shown a willingness to raid and redirect philanthropic dollars under their control. In Arizona, the state legislature recently voted in special session to redirect a $250,000 bequest from a private citizen to help cut the state's $140 million deficit. The gift, given by a Danish immigrant who "fell in love with Arizona," was intended to support the state's parks and was given to the Arizona State Parks Board upon her death.[13] The donor's intention in making the gift was of little concern to the

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[7]*Ibid*.

[8] *The Social and Economic Value of Private and Community Foundations*, The Philanthropic Collaborative (2008).

[9]*Obama's Plan to Reduce Charitable Deduction for Wealthy Draws Criticism*, CHRON. OF PHILANTHROPY, Feb. 26, 2009.

[10]*See Obama's Tax Plan Could Cause Giving by the Wealthy to Drop by Several Billion Dollars Annually*, CHRON. OF PHILANTHROPY, Feb. 27, 2009.

[11]Robert Reich argued this point in defending the 2009 proposal. *See Obama's Plan to Reduce Charitable Deduction for Wealthy Draws Criticism*, CHRON. OF PHILANTHROPY, Feb. 26, 2009.

[12]*An Analysis of California Pensions Finds Half-Trillion-Dollar Gap*, N.Y. TIMES, Apr. 6, 2010.

[13]*Widow's Hefty Donation to Arizona Parks Is Poached*, ARIZONA REP., Jan. 4, 2010.

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legislature in reallocating the money, as the bequest had not been slated for a specific purpose within the parks department. Nevertheless "she would have never given the money," a close friend said, "if she had known the state was going to take it away from the parks board."[14] In Colorado, state representative Ken Lambert made a similar play for a $125,000 gift to the state's Department of Natural Resources to help erase a $1.3 billion budget deficit, arguing that "in a budget emergency, it [the state] should use every dollar it can find to balance the budget."[15]

Will states refrain from redirecting private philanthropic dollars to right their budgetary woes? Or will they look to private foundation assets as tax revenues continue to decline and as their expenses increase?

5. *Empowering Regulators with Greater Organizational Management Oversight*. The 2008 tax year marked the first year in which nonprofit organizations filed the revised form 990 with the Internal Revenue Service. The new form has three goals according to the IRS: enhancing transparency, promoting tax compliance, and minimizing the burden on the filing organization. For some, however, the new form is an example of the federal agency overstepping its authority by requesting, under the threat of civil and criminal penalties, information related to an organization's management and governance that goes beyond the agency's legal authority under the Internal Revenue Code.

In *Tax Notes*, Marcus Owens writes that the IRS is clearly "assuming a new role in charity governance, and perhaps more broadly, other types of tax-exempt organizations. In doings so, it has publicly acknowledged that it is moving beyond the requirements of the code."[16] Indeed, in a 2007 speech cited by Owens, the commissioner of the IRS Tax Exempt and Government Entities Division said that "IRS involvement with good governance is not new. We have been quietly but steadily promoting good governance for a long time . . . . To more clearly put our weight behind good governance may represent a small step beyond our traditional sphere of influence, but we believe the subject is well within our core responsibilities."

Few would object to the notion that charitable organizations and private foundations ought to be governed and managed well. In the wake of the collapse of Wall Street's financial institutions, there may even be broad popular support for greater regulatory oversight and increased transparency in the nonprofit sector. The issue, however, is about whether or not the *IRS* should be assessing the governance and management of the nation's independent sector, and whether or not it has the *legal authority* to do so. Is the IRS slowly assuming the role of the nation's charity evaluator, rather than doing its job of strictly enforcing adherence to the law? Greater organizational transparency may sound good, but it could have a chilling effect on private philanthropy—and it could drive talent away from nonprofit management and governance.

Furthermore, making the IRS charity watchdog would invariably lead to a deadening standardization of the sector, stifling innovation, flattening local differences, and favoring organizations that adhere to the IRS's narrowly construed and subjective notions of what constitutes best management practices. In becoming the nation's nonprofit watchdog the IRS, in other words, would not merely affect how organizations report; it will influence how they behave, molding America's independent charitable sector to the preferred shape of big government.

***Conclusion: A Dependent Sector*.** The economic downturn and reform-minded political climate in Washington is already creating an atmosphere favorable to greater government meddling in the independent sector. These efforts to regulate, administer, and direct private philanthropy will ultimately lead to charities becoming more dependent on government—and, not incidentally, to a less generous America. And the poorest and most vulnerable among us will be the ones who suffer most.

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[14] *Ibid*.
[15] *Orphaned State Funds Find A Home*, DENVER POST, Mar. 2, 2010.
[16] *Charities and Governance: Is the IRS Subject to Challenge?*, TAX NOTES, May 12, 2008.