

Faculty Publications

2014

Evaluating Trickle Down Charity

Matthew Rossman

Case Western University School of Law, matthew.rossman@case.edu

Follow this and additional works at: https://scholarlycommons.law.case.edu/faculty_publications



Part of the [Tax Law Commons](#)

Repository Citation

Rossman, Matthew, "Evaluating Trickle Down Charity" (2014). *Faculty Publications*. 628.

https://scholarlycommons.law.case.edu/faculty_publications/628

This Article is brought to you for free and open access by Case Western Reserve University School of Law Scholarly Commons. It has been accepted for inclusion in Faculty Publications by an authorized administrator of Case Western Reserve University School of Law Scholarly Commons.

Evaluating Trickle Down Charity

A SOLUTION FOR DETERMINING WHEN ECONOMIC DEVELOPMENT AIMED AT REVITALIZING AMERICA'S CITIES AND REGIONS IS REALLY CHARITABLE

Matthew J. Rossman[†]

INTRODUCTION

Encouraging business creation and job growth by providing direct financial support, technical assistance, and other aid to private enterprises has become a nearly ubiquitous, core component of revitalization strategies in communities of every size and shape across America.¹ There is good reason for such a significant focus on this type of place-based economic development.² A favorable business climate within a place—be it a neighborhood, a city, a region, or a country—is critical to its

[†] Professor of Law, Case Western Reserve University School of Law. I would like to thank my colleagues Jonathan Entin, Paul Feinberg, Jessie Hill, Erik Jensen and Ken Margolis at Case Western Reserve University School of Law for reviewing and critiquing drafts of this article. I would also like to acknowledge the valuable research assistance provided by Erin Davis and Virginia (Mimi) Woelper, and the early brainstorming done on this topic with the law students in my Urban Development Lab: Erin Davis, Jordan Graham, Yeheng (Tracy) Li, Rachel Hessler Lyons, and Mandy McNabb. The contributions of all of the above helped make this a stronger piece and I am truly grateful to them.

¹ See, e.g., Louise Story, *Lines Blur As Texas Gives Industries Bonanza*, N.Y. TIMES, Dec. 2, 2012, available at http://www.nytimes.com/2012/12/03/us/winners-and-losers-in-texas.html?pagewanted=all&_r=0 (referring to a NEW YORK TIMES investigation revealing that state and local governments across the country give incentives to private businesses totaling \$80 billion a year).

² “Economic development” is commonly understood to mean the strategic structuring, restructuring and/or growth of an economy to enhance the economic well-being of people that live in a particular place. *Economic Development Reference Guide*, INT’L ECON. DEV. COUNCIL (2005), http://www.iedonline.org/?p=ED_Reference_Guide. “Place-based” economic development strategies are often distinguished from “people-based” economic development strategies, with the former focused on improving the climate for business within a place and the latter focused on improving access of individuals to economic opportunities (whether or not those opportunities are located in the place in which they reside). Randall Crane and Michael Manville, *People or Place? Revisiting the Who Versus the Where of Urban Development*, 20 LAND LINES 2, 7 (July 2008).

sustainability.³ Places that foster the creation and growth of businesses and startup companies create jobs at disproportionately high rates.⁴ In turn, places that create jobs draw people, resources, and vitality; those that lose jobs fail at those things.⁵ Relatively recent market forces like globalization and increased technological connectivity have only intensified the competition for sustainability by increasing the field of places for businesses and jobs to locate and the speed at which places become winners and losers.⁶

Notwithstanding perceptions of the American economy as a free market, its government at all levels is a huge player in fostering place-based economic development.⁷ Since the middle part of the twentieth century, the federal government has continuously, and with increasing frequency, rolled out incentive programs benefitting private companies designed to spur job creation and economic growth in certain American communities—typically those suffering some form of economic distress.⁸ During the same period, state and local governments,

³ See Eben Fodor, *Relationship between Growth and Prosperity in the 100 Largest U.S. Metropolitan Areas*, FODOR & ASSOCIATES.COM, http://www.fodorandassociates.com/Reports/Growth_& Prosperity_in_US_MSAs.pdf (Dec. 2010) (examining the relationship between growth and economic prosperity in the 100 largest U.S. metropolitan areas).

⁴ See *Frequently Asked Questions*, SBA OFFICE OF ADVOCACY, http://www.sba.gov/sites/default/files/FAQ_sept_2012.pdf (last updated Sept. 2012). Studies of U.S. census data demonstrate that small businesses account for approximately 65% of all net new jobs created in the country. The number of net new jobs created in the United States between 1980 and 2005 roughly equals the number of jobs created by start-up companies; see also *Kauffman Foundation-Funded U.S. Census Bureau Data Highlight Importance of Business Startups to Job Creation in the U.S.*, EWING MARION KAUFFMAN FOUND. (Jan. 14, 2009), <http://www.marketwired.com/press-release/kauffman-foundation-funded-us-census-bureau-data-highlight-importance-business-startups-1247741.htm>.

⁵ See Richard Florida, *The Rise of the Creative Class*, WASH. MONTHLY (May 2002), <http://www.washingtonmonthly.com/features/2001/0205.florida.html> (describing connection between growing cities and the ability to attract creative and entrepreneurial young residents); see also JENNIFER S. VEY ET AL., THE BROOKINGS INST. METRO. POLICY PROGRAM, *RESTORING PROSPERITY, THE STATE ROLE IN REVITALIZING AMERICA'S OLDER INDUSTRIAL CITIES*, (2007) (comparing American older cities that are prospering with those that are not, and identifying economic stagnancy as a critical factor in the condition of less prosperous cities).

⁶ See Robert I. Lerman & Stefanie R. Schmidt, *An Overview of Economic, Social, and Demographic Trends Affecting the US Labor Market*, U.S. DEPT OF LABOR, available at <http://www.dol.gov/dol/aboutdol/history/herman/reports/futurework/conference/trends/Trendsintro.htm> (Aug. 1999) (discussing globalization and its impact on US markets).

⁷ Story, *supra* note 1.

⁸ Major L. Clark & Radwan N. Saade, *The Role of Small Business in Economic Development of the United States: From the End of the Korean War (1953) to the Present* (Small Business Administration Office of Advocacy, Working Paper 2010), available at <http://www.sba.gov/advocacy/7540/12143> (describing the shift in federal economic development policies in mid-twentieth century toward place-based development fueled by small business creation); see also William H. Simon, *The Community Economic Development Movement*, 2002 WIS. L. REV. 377, 380-87 (2002) (describing federal place-based economic development programs throughout the second half of the twentieth century). Just a few examples include the Economic Development Administration of

motivated less by equity and more by self-preservation, have jumped into the economic development game with equal zeal and creativity.⁹ State, county, and municipal legislatures have equipped their governments with the capacity to extend an ever-widening array of tax credits and abatements, grants, and publicly financed or guaranteed loans to businesses large and small in order to keep them within their political boundaries.¹⁰

More recently, another player, seemingly an even-less likely character to foster private sector job creation, has risen to prominence: the nonprofit sector. A new wave of nonprofit organizations has emerged and is running venture capital funds, recruiting companies to major metropolitan areas, providing technical assistance to business owners, and in a multitude of other ways facilitating targeted economic growth in urban, suburban, and rural areas throughout the country.¹¹ These organizations, which this article refers to as “regional economic development organizations” or “REDOs,” have begun to make a significant impact on local and regional job growth in some areas,¹² and philanthropic and civic forces are increasingly

the 1960s (providing working capital loans to private companies in distressed regions coupled with public infrastructure improvements), Empowerment Zones and Enterprise Communities in the 1990s (offering packages of grants, regulatory waivers, tax-exempt bonding, and other tax benefits to attract businesses within a select group of the nation’s most severely distressed urban neighborhoods) and New Market Tax Credits begun in first decade of twenty-first century (incentivizing investment by private investors in businesses in low-income neighborhoods through offsetting tax credits).

⁹ Michael I. Luger, *The Role of Local Government in Contemporary Economic Development* (Lincoln Institute of Land Policy, Working Paper 2007); Timothy J. Bartik, *Local Economic Development Policies*, (Upjohn Institute for Employment Research, Working Paper 03-91, Jan. 2003).

¹⁰ See COUNCIL OF DEV. FIN. AGENCIES, <http://www.cdfa.net/> (last visited Apr. 11, 2014) (cataloging programs within state, county, and municipal governments across the country that provide or otherwise support economic development financing).

¹¹ Research conducted by the author indicates that all 50 major metropolitan areas in the United States (as determined by the United States Office of Budget and Management) are home to a nonprofit organization the primary mission of which is regional job creation through direct aid to for-profit businesses. A majority of the organizations identified were formed since 2000. See ERIN DAVIS & MATTHEW J. ROSSMAN, REDOS BY METROPOLITAN STATISTICAL AREA (2013) (on file with author); see, e.g., ANN ARBOR SPARK, <http://www.annarborusa.org/> (last visited Apr. 11, 2014); BIOCROSSROADS, <http://www.biocrossroads.com/Home.aspx> (last visited Apr. 11, 2014); BIOGENERATOR, <http://www.biogenerator.org/index.shtml> (last visited Apr. 11, 2014); THE BIZDOM, <http://bizdom.com/> (last visited Apr. 11, 2014); BRANDERY, <http://brandery.org/> (last visited Apr. 11, 2014); GREATER PHOENIX ECON. COUNCIL, <http://www.gpec.org/home> (last visited Apr. 11, 2014); JUMPSTART, <http://www.jumpstartinc.org>; INVEST NEBRASKA CORP., <http://www.investnebraska.com> (last visited Apr. 11, 2014); PITTSBURGH LIFE SCIS. GREENHOUSE, <http://www.plsg.com/> (last visited Apr. 11, 2014).

¹² See, e.g., *Message from Deputy Assistant Secretary Matt Erskine*, U.S. ECON. DEV. ADMIN. (June 2013), www.eda.gov/news/newsletters/2013/june.htm, (including a claim by BioGenerator (St. Louis) that its investments in its portfolio companies leveraged \$110 million in outside investment in 2012); see also *Reports*, JUMPSTART,

throwing their institutional and financial weight behind them.¹³ In the wake of the “Great Recession” of 2008, REDOs have become a darling of politicians and policy makers for engineering America’s economic turnaround, as they represent a largely noncontroversial blend of pro-business and anti-poverty objectives, while reinforcing the country’s entrepreneurial self-image.¹⁴

Central to this article is the recognition that many REDOs are operating not only as nonprofit organizations, but as charities.¹⁵ By “charities,” I mean nongovernmental organizations recognized by the Internal Revenue Service (IRS) under Section 501(c)(3) of the Internal Revenue Code.¹⁶ Section 501(c)(3) provides powerful tax, funding, and reputational advantages to charities. These include: (1) exemption from federal income tax (and, by extension, from many other types of federal, state, and local taxes and regulatory laws),¹⁷ (2) eligibility to receive contributions that are tax-deductible by individual and corporate donors from their federal income taxes,¹⁸ (3) eligibility for funding from government and foundation sources that are either not available to or harder to obtain for non-501(c)(3) organizations,¹⁹ and (4) the public credibility associated with having been scrutinized by the IRS and recognized as a charity.²⁰ Taken

www.jumpstartinc.org/results/reports.aspx (last visited Apr. 23, 2013) (study conducted by Cleveland State University, Levin College of Urban Affairs showing early-stage companies incubated by JumpStart (Cleveland) generated \$270 million in economic benefit for Ohio in 2012).

¹³ See THE FOUND. CTR., SPOTLIGHT ON ECONOMIC DEVELOPMENT GRANTMAKING IN OHIO (Mar. 2011), http://foundationcenter.org/gainknowledge/research/pdf/spotlight_ohio_2011.pdf (last visited Mar. 12, 2014) (showing that in Ohio alone, in 2008, grant awards from the state’s largest foundations to economic development organizations totaled \$61.8 million dollars, a 152% increase from 4 years earlier).

¹⁴ See, e. g., *Fact Sheet: White House Launches “Startup America” Initiative*, WHITEHOUSE.GOV available at <http://www.whitehouse.gov/startup-america-fact-sheet>.

¹⁵ See DAVIS & ROSSMAN, *supra* note 11 (showing that 49 out of 50 of the metropolitan statistical areas surveyed are home to a REDO recognized as a charity under Section 501(c)(3) and that in the one outlier, Las Vegas, plans are in place to begin a 501(c)(3) REDO); see also I.R.C. § 501 (c)(3) (2012).

¹⁶ I.R.C. § 501 (c)(3).

¹⁷ I.R.C. § 501(e)(3) provides federal income tax exemption for organizations described, including those organizations organized and operated exclusively for charitable purposes. Many states and municipalities provide automatic exemption from state and local tax to all organizations that are described in § 501(c)(3). In other states and municipalities, organizations must file additional paperwork and/or establish additional facts in order to be exempted from applicable income tax.

¹⁸ I.R.C. § 170 (2010).

¹⁹ BRUCE R. HOPKINS, *THE LAW OF TAX EXEMPT ORGANIZATIONS* 49 (10th ed. 2011); MARILYN E. PHELAN and ROBERT J. DESIDERIO, *NONPROFIT ORGANIZATIONS LAW AND POLICY* 169 (3rd ed. 2003).

²⁰ James J. Fishman, *Wrong Way Corrigan and Recent Developments in the Nonprofit Landscape: A Need for New Legal Approaches*, 76 *FORDHAM L. REV.* 567, 580 (2008) (“Traditionally, the recognition of exemption letter has been a seal of approval for foundations and other donors.”).

together, these advantages amount to a substantial public subsidy that incentivizes philanthropic activity.

The law reserves this subsidy for entities that are organized and operated exclusively for charitable purposes, which requires, among other things, serving public “rather than” private interests.²¹ Known as the private benefit doctrine, this requirement reflects a long-standing principle in the law related to charities that, for an organization to merit the “charitable subsidy,” the primary and direct beneficiaries of its activities must be the members of a charitable class. Any resulting benefit to private interests must be an incidental and insignificant byproduct of serving this class.²²

So what is the problem? Conceptually, the private benefit doctrine would seem to exclude many forms of economic development as charitable activity. Intrinsic to the work of almost any organization engaged in economic development is direct aid to for-profit businesses to generate private benefit (and lots of it). In theory, if enough of these businesses ultimately succeed, secondary public benefits like the creation of jobs or the revitalization of a distressed community follow. However, this represents a reversal of how the law defines charity—it is privately owned businesses which are the primary beneficiaries and the members of the charitable class who benefit incidentally. Even at its most altruistic, economic development is still “trickle down” charity.

Moreover, as the practice of charitable economic development has become more geographically ambitious and sophisticated, the relationship between the businesses aided and the benefit to members of a charitable class has become more attenuated and less predictable. REDOs exemplify this trend. Consider, for example, a REDO that creates a venture capital fund to invest in companies across a multi-county region that has an unemployment rate above the national average. How does one measure the private benefit internalized by the companies and their founders versus the public benefit enjoyed by the region as a whole and/or those individuals experiencing the effects of unemployment? Does an investment in a biotechnology company that may grow to employ 40 to 50 highly educated individuals serve primarily to benefit a disadvantaged region or the company’s founders and

²¹ Treas. Reg. § 1.501(c)(3)–1(d)(1)(ii)(2008).

²² *Am. Campaign Academy v. Comm’r*, 92 T.C. 1053, 1074 (1989). See I.R.S. Gen. Couns. Mem. 39,862 (Nov. 22, 1991).

those employees? Does a loan to retain a business in a suburban area 25 miles from the impoverished neighborhoods of a region's anchor city count as the type of "regional" public benefit that accomplishes charitable ends?

Given the potential complexities associated with squaring economic development activity with Section 501(c)(3), one would assume that there is a careful and consistent method for evaluating when a charity engages in work that falls under the private benefit doctrine. Unfortunately, for this purpose, the tax law's standard analytic structure is rudimentary and abstract. The IRS uses a largely intuitive, gut reaction in making an initial determination about private benefit when an organization applies for 501(c)(3) status and thereafter pays virtually no attention to the organization's achievement of a sufficient public/private benefit balance.²³

Although the standard practice may work well enough for more conventional charities like soup kitchens and afterschool programs, it is too blunt an instrument to adequately measure and decipher the relationship between public and private benefit generated by the activities of twenty-first century economic development organizations. Considering that the private benefit doctrine should be the critical factor in assessing when economic development is charitable, the status quo is problematic.

The principal consequence is that a growing number of economic development organizations take full advantage of the significant tax and funding benefits and related goodwill associated with 501(c)(3) status even though they are directing aid to businesses and individuals who may be anything but distressed, without demonstrating benefit to those considered to be proper recipients of charity. Millions of tax-advantaged dollars²⁴ intended for charitable purposes flow to organizations that are not accountable. Many economic development charities are clearly accomplishing charitable purposes. But the lack of accountability means that others are not, and yet are benefitting from the charitable subsidy and, in some instances, attracting funds that would otherwise support genuinely charitable causes.²⁵ The IRS has the responsibility to scrutinize charities carefully in order to protect the integrity of the charitable sector and prevent misuse of the substantial public subsidy that the sector enjoys. Given that regions across the

²³ See *infra* Part IV.A & C.

²⁴ See *e.g.*, THE FOUND. CTR., *supra* note 13.

²⁵ See *infra* Part IV.D.

country are utilizing REDOs at an increasing rate, the time is ripe to address this problem.

This article examines the recent evolution of charitable economic development, how the current jurisprudence and IRS practices assess it, and how these could be changed to better decipher when economic development is really charitable. Ultimately, this article proposes that the IRS apply the private benefit doctrine more carefully, consistently, and frequently to economic development organizations claiming charitable status.

Part I briefly discusses the genesis and expansion of charitable economic development. Parts II and III summarize the law of Section 501(c)(3) of the Internal Revenue Code as it relates to private benefit generally and organizations engaged in charitable economic development specifically. Part IV makes a fuller case for why the current jurisprudence and the IRS do not adequately assess and monitor charitable organizations engaged in twenty-first century economic development and the harm that results. Part V identifies a range of possible solutions to this problem and considerations to bear in mind when choosing among these solutions. Finally, Part VI sets forth my recommended solution.

I. A BRIEF HISTORY OF ECONOMIC DEVELOPMENT BY AMERICAN CHARITIES

A. *An Overview*

Briefly examining the history and evolution of place-based charitable economic development in the United States aids in understanding why Section 501(c)(3) jurisprudence relating to these organizations evolved as it did and why the time is ripe for readdressing it.

Despite a popular perception of charity as acts of compassion that meet the most basic needs of the poor, the relationship between economic development—in the sense of providing opportunities for gainful employment—and charity is actually long-standing and deeply rooted in Anglo-American culture.²⁶ Charity connected to providing the mechanisms for cultivating wealth reflects an intrinsic American value—that promoting entrepreneurship and economic self-sufficiency addresses the root cause of poverty rather than merely

²⁶ Thomas Kelley, *Rediscovering Vulgar Charity: A Historical Analysis of America's Tangled Nonprofit Law*, 73 *FORDHAM L. REV.* 2437, 2451 (2005).

alleviating its symptoms.²⁷ This is evidenced throughout the history of American charity, from its early influence in the ascetic Protestantism and industrious spirit of prominent colonialist-era thinkers like Cotton Mather and Benjamin Franklin, to the “friendly visitors” and “scientific philanthropy” movements of the late nineteenth and early twentieth centuries, all of which emphasized the promotion of work and enterprise over indiscriminate almsgiving as the more appropriate approach to meeting the needs of the poor.²⁸

Also well-entrenched is the notion that economic development has the potential to address the broader needs of an entire community, rather than just the basic sustenance of needy individuals. One early American example is the debate between prominent black leaders Booker T. Washington and W.E.B. DuBois around the turn of the nineteenth century over the role of business ownership and economic independence within the black community as a way of achieving political enfranchisement and civil rights for recently emancipated slaves.²⁹ This concept has carried over and expanded greatly into modern day movements like social entrepreneurship and venture philanthropy which attempt to apply for-profit business models and market-oriented solutions to societal challenges like protecting the environment, eradicating urban food deserts, and ensuring fair wages to low-income migrant workers.³⁰ As for economic development specifically aimed at revitalizing geographically defined communities and implemented by “charities,” it was the Community Economic Development (CED) movement in the 1960s that brought this strategy to prominence.

B. Community Economic Development

The genesis of CED was largely influenced by the failure of the federal government’s partnership with municipal agencies and private developers to satisfactorily revitalize blighted American urban areas in the 1950s through the Urban

²⁷ *Id.*

²⁸ *Id.* at 2453-54.

²⁹ Scott J. Cummings, *Community Economic Development As Progressive Politics: Toward a Grass-Roots Movement for Economic Justice*, 54 STAN. L. REV. 399, 410 (2001). See generally Jonathan L. Entin, *Justice Thomas, Race, and the Constitution Through the Lens of Booker T. Washington and W.E.B. DuBois*, 88 U. DET. MERCY L. REV. 755 (2011).

³⁰ Dana Brakman Reiser, *For-Profit Philanthropy*, 77 FORDHAM L. REV. 2437, 2472 (2009).

Renewal program.³¹ Urban Renewal proved widely unpopular and unsuccessful, in part because its top down approach to planning and decision-making excluded those who resided in the affected areas and often resulted in bulldozing wide swaths of buildings occupied by low-income and minority residents and replacing them with commercial buildings or vacant lots.³²

In its place came the federal Economic Opportunity Act of 1964 and the Community Action Program (and later the Special Impact Program) which instead delegated governmental authority and funding for a wide range of community improvement activities to “community action programs” organized within distressed communities and involving “maximum flexible participation” by community residents.³³ This model, which was based on a template previously funded by the Ford Foundation through its Gray Areas program, came to be known as Community Economic Development.³⁴ The need for local organizational actors as vehicles to carry out CED gave rise to the creation of community development corporations (CDCs).³⁵

CDCs were typically established as charitable 501(c)(3) corporations empowered to meet a broad range of a distressed community’s needs. These needs might include acquiring and rehabilitating blighted buildings, developing affordable housing, managing community-based health centers and credit unions, and overseeing the local delivery of social services and other public aid programs.³⁶ An important subset of many CDCs’ activities also included local economic development as a mechanism for creating economic activity and jobs within the community.³⁷ Early CDCs provided loans, loan guarantees, and

³¹ Roger A. Clay, Jr. & Susan R. Jones, *What is Community Economic Development?*, in BUILDING HEALTHY COMMUNITIES: A GUIDE TO COMMUNITY ECONOMIC DEVELOPMENT FOR ADVOCATES, LAWYERS, AND POLICYMAKERS, 5-11 (Roger A. Clay Jr. & Susan R. Jones, eds. 2009) (discussing the history and background of community economic development); see Brian Glick & Matthew J. Rossman, *Neighborhood Legal Services as House Counsel to Community-Based Efforts to Achieve Economic Justice: The East Brooklyn Experience*, 23 N.Y.U. REV. L & SOC. CHANGE 105, 107 (1997).

³² Simon, *supra* note 8; see also David J. Barron, *The Community Economic Development Movement: A Metropolitan Perspective*, 56 STAN L. REV. 701, 706-08 (2003) (noting that tenants and homeowners already in place often fared poorly under Urban Renewal).

³³ See Economic Opportunity Act of 1964, Pub. L. No. 88-452, § 201, 78 Stat. 508 (1964) (repealed 1981).

³⁴ Clay & Jones, *supra* note 31, at 7.

³⁵ *Id.*

³⁶ See Cummings, *supra* note 29, at 438-41; Glick & Rossman, *supra* note 31, at 107-08.

³⁷ Glick & Rossman, *supra* note 31, at 109; see Cummings, *supra* note 29 at 401-08; Michael Schill, *Assessing the Role of Community Development Corporations in Inner-City Economic Development*, 22 N.Y.U. REV. L. & SOC. CHANGE 753, 768 (1997)

stock purchases as specialized financing for businesses and cooperatives owned by community members who did not meet the lending standards of conventional lenders.³⁸ They developed retail centers to provide local shopping and other amenities in places conventional developers would not touch.³⁹ Occasionally they even owned and operated local companies (usually with the intention that stock in these companies would be made available to employees and local residents).⁴⁰

There was little question that *community* economic development qualified as *charitable* economic development even though it aided for-profit businesses. The missions of CDCs revolved around the re-development of relatively small and geographically distinct neighborhoods in heightened states of distress due to high rates of poverty, blight, and deterioration.⁴¹ CED is a comprehensive approach, addressing a wide range of causes and complications of poverty, and, thus, the particular activities a CDC undertook were necessarily tied to the needs of the community it served.⁴² In other words, when CDCs engaged in economic development, it was in response to an identified need of a distressed community. Adding credibility to this assessment was the fact that the leadership of CDCs, by design, was largely composed of, sought input from, and was ultimately accountable to the residents and other stakeholders of the poor and distressed communities they served.⁴³ As Part III of this article later explains, the IRS rulings that continue to govern the agency's approach to charitable economic development

("[O]ne objective common to virtually all CDCs is the desire to generate economic opportunity and jobs for the residents of their communities.")

³⁸ COLEMAN ET AL., THE NATIONAL HOUSING & ECONOMIC DEVELOPMENT LAW PROJECT, A LAWYERS' MANUAL ON COMMUNITY-BASED ECONOMIC DEVELOPMENT 15-17 (1974).

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ See Cummings, *supra* note 29, at 415-16 (discussing the roots of modern CDCs in distressed urban neighborhoods); Barron, *supra* note 32, at 714.

⁴² NEAL R. PIERCE & CAROL F. STEINBACH, CORRECTIVE CAPITALISM: THE RISE OF AMERICA'S COMMUNITY DEVELOPMENT CORPORATIONS 20-21 (1987); Ben Quinones, *Serving Clients in New Ways: Community Economic Development, CED on the Job*, 27 CLEARINGHOUSE REV. 773, 773-74 (1993).

⁴³ See Anna Clark, *Welcome to Your New Government: Can Non-Profits Run Cities?*, FOREFRONT (Next Am. City, Phila., PA), at 1, <http://nextcity.org/forefront/view/welcome-to-your-new-government> ("[T]he key way that CDCs establish themselves as representatives of their community is by allotting a certain number of seats on their board to residents."); see also NAT'L CONG. FOR CMTY. ECON. DEV., *Reaching New Heights: Trends and Achievements of Community-Based Development Organizations*, NAT'L CONG. FOR CMTY. ECON. DEV. 4, 7 (2005), <http://community-wealth.org/sites/clone.community-wealth.org/files/downloads/report-ncced.pdf>.

were handed down in the 1970s, when nonprofit economic development organizations were predominantly CDCs.⁴⁴

Despite the eventual demise in the 1970s of the federal programs that gave rise to them, CDCs proved to be very resilient and are now a pervasive component of strategies for addressing the needs of both low and moderate income communities throughout the country.⁴⁵ While many still operate under the guise of a traditional CDC located in storefronts in the center of the neighborhoods they serve, these days an increasingly complex network of financial intermediaries, technical assistance providers, and national foundations help to facilitate CED. CDCs themselves have taken on more complicated structures and activities, particularly in the economic development arena.⁴⁶ Even so, CED is still viewed primarily as a poverty alleviation and blight amelioration strategy confined to distressed areas and, thus, as firmly charitable.⁴⁷

C. *Regional Economic Development*

The emergence of CED in the 1960s did not represent an abdication of place-based economic development by other interests. As described in the Introduction, the government has played an ever-increasing role in promoting place-based economic development.⁴⁸ Another set of stakeholders includes businesses (especially those headquartered in a community), local foundations, and nonprofit institutions (like hospitals, the arts, universities, and schools) that have “sticky capital” in a community.⁴⁹ In some instances, these stakeholders are well

⁴⁴ *Infra* Part III.

⁴⁵ According to a 2005 census, the number of CDCs nationally had grown from approximately 100 in the 1960s to approximately 4,600 in 2005. *Reaching New Heights*, *supra* note 43 at 8. There are CDCs in urban and rural areas in all 50 states with diverse programs and objectives. Dana A. Thompson, *The Role of Nonprofits in CED*, in *BUILDING HEALTHY COMMUNITIES: A GUIDE TO COMMUNITY ECONOMIC DEVELOPMENT FOR ADVOCATES, LAWYERS AND POLICYMAKERS* 58 (Roger A. Clay, Jr. & Susan R. Jones, eds. 2009).

⁴⁶ *See Reaching New Heights*, *supra* note 43, at 19-20 (noting that the community development field began to attract new money from state and local governments, foundations, banks, corporations, and religious organizations, which are helping to drive the field forward); *see also* Schill, *supra* note 37, at 753 (describing the various roles CDCs are playing in economic development: development catalyst, developer/landlord and equity investor in business enterprises).

⁴⁷ *See generally* Cummings, *supra* note 29.

⁴⁸ *Supra* INTRODUCTION; *see generally* VEY ET AL., *supra* note 5.

⁴⁹ *See* VEY ET AL., *supra* note 5, at 40-41. “Sticky Capital” is a phrase used frequently by Ted Howard of the Democracy Collaborative to describe investments in a community that are unlikely to “get up and leave” to another part of the country. Examples include college campuses, hospitals, and nonprofit foundations that have a

integrated in localized CED strategies spearheaded by a CDC.⁵⁰ However, increasingly more often over the past few decades, these stakeholders are *also* or *instead* involved in broader efforts to address economic development across a city, a region, or even an entire state carried out by independent nongovernmental, nonprofit organizations.⁵¹ It is these organizations that this article categorizes as regional economic development organizations (REDOs).

The rise in REDOs is attributable to several factors, three of which are emphasized here. The first is the more formalized role that the so-called corporate elite began to play in urban economic planning and development beginning in the 1980s in cities across the country. Nestled within any American city of a significant size is a network of business, political, and other institutional leaders whose professional interests are closely linked to local development and growth, and who have the means and influence to impact it.⁵² One commentator has coined this network the “growth machine.”⁵³

While informally influential from the times these cities first emerged, the growth machine in many of America’s eastern and midwestern cities also began to coalesce in the 1980s into nonprofit organizations set up for the specific purpose of counteracting the impact on these cities caused by the decline in manufacturing and heavy industry.⁵⁴ From Cleveland to Charlotte and Hartford to Kansas City, the leaders of those companies that profited when times were good entered into public-private partnerships with local governments and foundations to draw up and implement blueprints for economic survival and retrenchment, as well as

long history in a particular community. See, e.g., Ted Howard & Steve Dubb, *Leveraging Anchor Institutions for Local Job Creation and Wealth Building*, in *BIG IDEAS FOR JOBS* (Berkeley Institute for Research on Labor & Employment ed., 2012), available at www.irlle.berkeley.edu/research/jobcreation/howard_2011ppt.

⁵⁰ *Reaching New Heights*, *supra* note 43, at 7 (discussing CDCs as organizations, showing a chart of CDC’s service areas and noting that two-thirds of CDCs have a distinctly local focus).

⁵¹ See VEY ET AL., *supra* note 5, at 68.

⁵² See generally BUSINESS ELITES AND URBAN DEVELOPMENT: CASE STUDIES AND CRITICAL PERSPECTIVES (Scott Cummings ed. 1988).

⁵³ See Harvey Molotch, *Strategies and Constraints of Growth Elites*, in BUSINESS ELITES AND URBAN DEVELOPMENT: CASE STUDIES AND CRITICAL PERSPECTIVES 25 (Scott Cummings ed. 1988).

⁵⁴ Patricia Atkins et al., *Responding to Manufacturing Job Loss: What Can Economic Development Policy Do*, BROOKINGS METROPOLITAN POLY PROGRAM (2011).

physical redevelopment.⁵⁵ This model of economic development has persisted and expanded throughout the country, buoyed by an infusion of public and philanthropic dollars.⁵⁶ In most cases, these coalitions now include a widening array of partners including representatives from hospitals, universities, foundations, and new and emerging businesses.⁵⁷

A second factor is the broadening range of circumstances in which regions are utilizing REDOs. Communities are no longer “hold[ing] off on pursuing economic development strategies until the bottom falls out of the local economy”; they are taking a longer-range view of economic development and pursuing preventative strategies to ward off economic decline before it starts to take hold.⁵⁸ Economic development has become a matter of significant public concern and focus, regardless of whether a region is poor, affluent, or somewhere in between.⁵⁹

Third, there is a growing consensus among those who practice and analyze local economic development that the individual economies of small geographic areas like neighborhoods and even cities are less relevant in the face of globalization. Local political boundaries are less relevant because metropolitan regions must compete for jobs and companies on a global basis.⁶⁰ The notion that one neighborhood or municipality within a larger region “wins” by attracting a business from an adjoining neighborhood or municipality is rapidly being replaced by the belief that each region must identify and coordinate its distinctive strengths and assets if it

⁵⁵ *Id.*; David O. Renz, *The Case of Kansas City*, in PHILANTHROPY AND THE NONPROFIT SECTOR IN A CHANGING AMERICA (Charles T. Clotfetter & Thomas Ehrlich, eds. 2001).

⁵⁶ See, e.g., THE FOUND. CTR., *supra* note 13.

⁵⁷ Ted Howard & Steve Dubb, *Leveraging Anchor Institutions for Local Job Creation and Wealth Building*, in BIG IDEAS FOR JOBS (Berkeley Institute for Research on Labor & Employment ed., 2012).

⁵⁸ Tomer J. Inbar, *Charities and Economic Development*, in GEORGETOWN UNIVERSITY LAW CENTER CONTINUING LEGAL EDUCATION PROGRAM ON REPRESENTING AND MANAGING TAX-EXEMPT ORGANIZATIONS (Apr. 27, 2006), http://www.morganlewis.com/pubs/inbar_georgetown06-economicdevel.pdf.

⁵⁹ See *Growing Your Region's Economy with Small Businesses and Entrepreneurs*, NAT'L ASS'N OF DEV. ORGS. RESEARCH FOUND. (Dec. 2011), <http://www.nado.org/wp-content/uploads/2012/01/rif2012.pdf> (stating that there are over 500 regional economic development organizations in the U.S. that are composed principally of local governmental officials and charged generally with developing and implementing regional economic development policies). These organizations cover virtually every section of the United States. *2011 RDO Organizational Data Profiles*, NAT'L ASS'N OF DEV. ORGS. 4 <http://www.nado.org/wp-content/uploads/2011/04/2011-National-Profiles-of-RDOs-FINAL.pdf> (last visited Mar. 6, 2014).

⁶⁰ Claire Felbinger & James Rohey, *Globalization's Impact on State and Local Policy: The Rise of Regional Cluster Based Economic Development Strategies*, 18 REV. POL'Y RESEARCH 63, 64-79 (2001).

hopes to survive in an era when jobs and capital can easily find lower cost alternatives in other regions or countries.⁶¹ In this way, economic development must extend beyond the boundaries of highly distressed communities if it is to make a sustainable impact.

D. *What Are REDOs and What Do They Do?*

While REDOs resemble CDCs in encouraging and facilitating place-based economic development, they differ in significant ways. CDCs typically serve relatively confined areas with high concentrations of poverty: a poor neighborhood or cluster of neighborhoods in urban settings, or a larger contiguous poor area in rural settings where there is less population density.⁶² REDOs, on the other hand, normally serve one or more contiguous metropolitan areas in urban settings, or an area as large as an entire state in rural settings.⁶³ The service area of a REDO usually contains multiple sub-communities that are faring differently in terms of economic health, household income, individual educational attainment, and other demographics that reflect an area's relative wealth.⁶⁴ Accordingly, REDOs serve an area large enough that they include sections that are distressed, some that are prosperous, and others that fall somewhere in between.⁶⁵

CDCs address a comprehensive range of needs within a community, including economic development,⁶⁶ while REDOs focus exclusively on economic development.⁶⁷ The leadership of a CDC typically represents a broad cross-section of stakeholders in the community it serves and is elected by community residents.⁶⁸ REDOs, on the other hand, are typically governed by

⁶¹ Mark Drabensott, *Rethinking Federal Policy For Regional Economic Development*, FED. RESERVE BANK OF KANSAS CITY ECON. REV. (2006), <http://www.kc.frb.org/publicat/econrev/PDF/1q06drab.pdf>.

⁶² See *Reaching New Heights*, *supra* note 43, at 7-8; see also THOMPSON, *supra* note 45, at 58.

⁶³ See, e.g., GREATER PHOENIX ECONOMIC COUNCIL, *supra* note 11 (serving 23 communities including and surrounding Phoenix, AZ); JUMPSTART, <http://www.jumpstartinc.org/aboutus/whatwedo.aspx> (2014) (serving 21 counties of Northeast Ohio); INVEST NEBRASKA CORP., www.investnebraska.com/about-us/whom-we-serve/ (2014) (service area includes entire state of Nebraska).

⁶⁴ See, e.g., *Mapping Poverty in America*, N.Y. TIMES (Jan. 4, 2014), <http://www.nytimes.com/newsgraphics/2014/01/05/poverty-map/>. (mapping the diversity in wealth of the areas served by the REDOs cited in preceding footnote).

⁶⁵ See, e.g., *Mapping Poverty in America*, *supra* note 64.

⁶⁶ See *supra* notes 34-37 and accompanying text.

⁶⁷ See, e.g., GREATER PHOENIX ECONOMIC COUNCIL, <http://www.gpec.org/about-us/>; JUMPSTART, <http://www.jumpstartinc.org/aboutus.aspx>; BIOGENERATOR, <http://www.biogenerator.org/> (2014).

⁶⁸ See *supra* note 43 and accompanying text.

self-perpetuating boards consisting largely of business leaders and economic development experts, many of whom are not directly accountable to those who live within the region.⁶⁹

To provide a better sense of what REDOs do and the context in which they do it, brief descriptions of three hypothetical REDOs are set forth below. These descriptions closely mirror types of REDOs that are being utilized with increasing frequency by communities across the country and are often recognized by the IRS as charities.⁷⁰

1. The Business Accelerator⁷¹

This organization is located in a large city in an area of the country that is considered economically depressed. The city is afflicted by many indicators of distress, including blighted and abandoned properties, high unemployment rates, high crime, and low high school and college graduation rates among its residents. The Business Accelerator seeks to help grow the economic base not only in the city but also in its surrounding region by assisting entrepreneurs leading high growth potential companies across the entire 15 county region that surrounds the city. This type of organization operates under the premise that, by helping local entrepreneurs get through the early stages when many companies fail, more companies will get off the ground, expand, and remain in the region, and thus expand local job opportunities.

The Business Accelerator's largest program activity involves making seed capital investments in early-stage ideas and small companies to help them grow to a point where they can bring their products and services to market and attract more conventional sources of financing. Once it makes an investment, the Business Accelerator matches the company with one of its "entrepreneurs in residence" to help guide the company's leadership during the term of the Business Accelerator's investment. The Business Accelerator's other services include connecting entrepreneurs to other sources of capital and providing low cost or no cost technical assistance to business

⁶⁹ See, e.g., GREATER PHOENIX ECONOMIC COUNCIL, *supra* note 67; JUMPSTART (2014), <http://www.jumpstartinc.org/aboutus.aspx>; BIOGENERATOR (2014), <http://www.biogenerator.org/>.

⁷⁰ See Davis & Rossman, *supra* note 11, for a representative list of REDOs, all of which the IRS has determined to be 501(c)(3) organizations operating for charitable purposes.

⁷¹ The organization described as The Business Accelerator resembles JumpStart, Inc., based in Cleveland, Ohio. See JUMPSTART, *supra* note 11.

owners on issues like public relations and marketing, identifying and attracting employees with the right skills, commercializing a technology, generating sales, achieving milestones, and most other issues that a startup business would face.

The Business Accelerator receives its financial support from a wide range of regionally based charitable foundations and individual and corporate donors, as well as from state government. Its board of directors consists primarily of local business leaders, who are themselves usually successful entrepreneurs, with some representatives from civic organizations and government.

2. The Biotech Incubator⁷²

This organization is located in a region that, while not technically economically depressed, has stagnant job growth rates and an aging economic base typified by companies founded and headquartered in the region many decades ago that no longer provide the number of jobs they once did. The Biotech Incubator's mission is to facilitate the formation of science, research-based, and technology companies to support new economic development and job growth in the region. The organization was established and is funded and overseen by local business, research, and university leaders who decided to draw upon the region's historic universities and research institutions to re-position the region against increasing domestic and global competition for new companies and talented young workers.

The Biotech Incubator engages in several types of activities specifically tailored to incubating new biotech companies. The organization works closely with regional universities and research institutions to identify promising ideas, technologies, and inventions, and to educate the associated researchers and entrepreneurs about commercialization and business development possibilities. It provides additional assistance to promising candidates through business plan development and, in some cases, serves as part of a new company's management team during its early phases. The organization helps companies it works with to identify, apply for, and communicate with providers of promising sources of capital, while also working to attract venture capital funds to

⁷² The organization described as The Biotech Incubator resembles BioGenerator, based in St. Louis, MO. See BIOGENERATOR, *supra* note 11.

the region. Finally, the Biotech Incubator operates “Accelerator Labs,” which consist of wet laboratory and office space that it makes available to early-stage companies at below market rates or for free (under some circumstances). These labs allow the companies to focus on demonstrating the viability of their technology by defraying the early stage costs of purchasing equipment and renting laboratory space.

3. The Regional Business Advocate⁷³

This organization is located in a region of the country that is experiencing both economic and population growth, anchored by a city that is already prosperous, but positioning itself to grow. The Regional Business Advocate seeks to cultivate industries that bring high-quality, high-wage jobs to the city and its surrounding counties, with a specialized focus on attracting renewable energy and international companies.

It carries out this mission through three primary and closely related categories of activities. The first is business development. The organization participates in efforts to lure companies and jobs to relocate to the region by helping connect prospective companies and governmental agencies that are sources of tax credits and other relocation assistance, promoting legislative strategies for adopting business-friendly devices like renewable energy tax credits, and hosting company and industry leaders on trips to the region. The second is marketing. The organization creates films, websites, and other materials promoting the region to show to chief executives and site selection consultants of companies seeking to relocate. Third, the organization identifies industries that have significant potential for growth in the region, and produces reports on how to target and grow these industries.

In many ways, the Regional Business Advocate acts like an economic development division of local government. But it is an independent organization, with roughly equal amounts of public and private funding, and a board of directors that consists of a combination of business leaders, government officials, and heads of universities and local foundations.

⁷³ The organization described as The Regional Business Advocate resembles The Greater Phoenix Economic Council based in Phoenix, AZ. See GREATER PHOENIX ECONOMIC COUNCIL, *supra* note 11.

II. ESSENTIALS OF SECTION 501(C)(3)

Many REDOs operate as charities,⁷⁴ which is to say that the IRS recognizes them as qualifying for tax exemption under Section 501(c)(3) of the Internal Revenue Code.⁷⁵ Qualifying under Section 501(c)(3) is the principal step for a nonprofit organization to access the substantial public subsidy available to charities.⁷⁶ Before discussing how the IRS applies Section 501(c)(3) to economic development, it is important to understand some of the basic components of Section 501(c)(3), with an emphasis on those that relate to the definition of “charitable” and the private benefit doctrine.

A. *Eligibility for 501(c)(3) Status*

All organizations described within the 29 subcategories of Section 501(c) of the Internal Revenue Code are exempt from federal income tax.⁷⁷ The largest and most well-known subcategory is Section 501(c)(3).⁷⁸ Included within Section 501(c)(3) are “[c]orporations . . . organized and operated exclusively for *religious, charitable, scientific . . . or educational purposes . . .*”⁷⁹ Although each of these terms has a distinct definition under 501(c)(3),⁸⁰ each overlaps with the definition of charitable and, in fact, almost all organizations seeking 501(c)(3) status for place-based economic development work seek to justify their activities as furthering “charitable” purposes.⁸¹ For simplicity’s sake, this article refers to any economic development conducted by a 501(c)(3) organization as “charitable economic development.”

⁷⁴ See Davis & Rossman, *supra*, note 11.

⁷⁵ I.R.C. § 501(c)(3) (2012).

⁷⁶ See *supra* text accompanying notes 17-20.

⁷⁷ I.R.C. § 501(c).

⁷⁸ AMY S. BLACKWOOD ET AL., THE NONPROFIT SECTOR IN BRIEF: PUBLIC CHARITIES, GIVING AND VOLUNTEERING, 2012, 1-2 (Oct. 5, 2012), <http://www.urban.org/publications/412674.html> (documenting that in 2010 there were 1.6 million organizations registered with the IRS under section 501(c), nearly 1.1 million of which were recognized as 501(c)(3) organizations).

⁷⁹ I.R.C. § 501(c)(3) (emphasis added). There are other categories of purposes listed in section 501(c)(3), but they are more obscure and not related to the topic at hand.

⁸⁰ I.R.S. Pub. 557, 46573C (Oct. 2013).

⁸¹ See generally JANE C. NOBER, ECONOMIC DEVELOPMENT: A LEGAL GUIDE FOR GRANTMAKERS 1-29 (2005). I am excluding from this article discussion of economic development organizations that seek 501(c)(3) status purely for educational (e.g. a business incubator set up as part of a university’s MBA program) or scientific (e.g. to fund research in a particular field) purposes as these organizations are not principally pursuing charitable objectives.

The word “charitable” is defined in the regulations amplifying the Internal Revenue Code (the IRC Regulations) both broadly by reference to the “generally-accepted legal sense” of the word as well as by reference to a list of specific purposes the word is understood to include.⁸² Most pertinent from this list of specific purposes for economic development organizations are “relief of the poor and distressed or of the underprivileged”; “promotion of social welfare by organizations designed . . . to lessen neighborhood tensions[,] . . . eliminate prejudice and discrimination[,] . . . or . . . combat community deterioration”; and “lessening of the burdens of Government.”⁸³ Subject to a few exceptions, any organization that wishes to be recognized as qualifying under Section 501(c)(3) must submit an application to the IRS demonstrating that it is organized for and its activities will exclusively further these types of purposes and receive an IRS determination letter officially recognizing its 501(c)(3) status.⁸⁴

B. *The Private Benefit Doctrine*

Nestled well within the IRC Regulations amplifying Section 501(c)(3) is the “private benefit doctrine.” It is rooted in language stating that an organization is not organized or operated exclusively for exempt purposes under Section 501(c)(3) “unless it serves a public rather than a private interest.”⁸⁵

Although this phrase has generated considerable confusion as to how and when the private benefit doctrine applies,⁸⁶ there is a near-consensus among commentators, courts, and the IRS on several critical points. First, the private benefit doctrine derives from the operational test of Section 501(c)(3); in other words, it clarifies that an organization cannot be operated exclusively for exempt purposes, no matter what it states as its purposes, unless its activities in fact

⁸² Treas. Reg. § 1.501(c)(3)–1(d)(2) (2013).

⁸³ *Id.*; see also Instructions for IRS Form 1023 (June 2006).

⁸⁴ I.R.C. § 508(a) (2012) (requiring that organizations requesting recognition under section 501(c)(3) submit an application, subject to certain exceptions). In addition to demonstrating that it is organized for and its activities further charitable purposes exclusively, the organization must also convince the IRS that it will avoid certain activities that 501(c)(3) prohibits including (i) lobbying (beyond an insubstantial amount), (ii) political campaigning, and (iii) allowing those who control the organization from unduly profiting based on their positions of control (what the statute characterizes as “private inurement”). I.R.C. § 501(c)(3).

⁸⁵ Treas. Reg. § 1.501(c)(3)–1(d)(1)(ii).

⁸⁶ John D. Colombo, *In Search of Private Benefit*, 58 FLA. L. REV. 1063, 1064 (2006) (discussing the difficulty of defining the private benefit doctrine).

primarily result in public benefit.⁸⁷ Second, although the “rather than” language in the regulation implies that the organization cannot serve any private interest, the correct interpretation of this phrase is that any benefit to private interests arising from the organization’s activities must result only incidentally from serving public interests.⁸⁸ Finally, the private benefit doctrine applies to all those who benefit from the organization’s activities and not just to those who control the organization.⁸⁹

So, conceptual issues aside, what does the private benefit doctrine really mean? Read literally, it means that the activities of a 501(c)(3) organization must principally benefit the public and not private individuals or companies. Of course, the service of public and private interests cannot be understood as mutually exclusive concepts. The public is composed of individuals, so any benefit to the public necessarily benefits private individuals.⁹⁰ Those who are patients of charitable hospitals receive medical care, those who attend the symphony hear music, and those who go to a soup kitchen receive a free meal.

Rather, private benefit is thought of as benefit bestowed upon individuals who are not part of the group of individuals who are the intended beneficiaries of the organization’s charitable purpose (the organization’s charitable class). Thus, the charitable class for the hospital is its patients, for the symphony is its listeners, and for the soup kitchen is those who are hungry and without adequate means to provide food for themselves. In each case, benefit bestowed upon members of the charitable class is considered public benefit and, therefore, acceptable.⁹¹

The private benefits generated by the activities of a charity are typically not limited to the members of its charitable class, however. The hospital must pay its doctors

⁸⁷ This point is clear given the language of the regulation from which the private benefit doctrine arises (“An organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph unless it serves a public rather than a private interest.”). Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii); see also HOPKINS, *supra* note 19, at § 20.11; Daryll K. Jones, *Third-Party Profit-Taking in Tax Exemption Jurisprudence*, 2007 BYU L. REV. 977, 998 (2007).

⁸⁸ See Jones, *supra* note 87, at 998-1002.

⁸⁹ Accordingly, the private benefit doctrine is distinct from Section 501(c)(3)’s express prohibition on taking the profits of the organization, which applies only to those who are in control of it. *Am. Campaign Acad. v. Comm’r*, 92 T.C. 1053, 1069 (1989) (determining that “nonincidental benefits conferred on disinterested persons may serve private interests”); see also *Redlands Surgical Servs. v. Comm’r*, 113 T.C. 47, 74 (1999).

⁹⁰ Andrew Morgan et al., *Private Benefit Under IRC 501(c)(3)*, in IRS EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION FOR THE FISCAL YEAR 2001, 135-36, available at <http://www.irs.gov/pub> (follow “irs-tege” hyperlink; then follow “ectopic01.pdf” hyperlink); see also Colombo, *supra* note 86, at 1070.

⁹¹ Jones, *supra* note 87, at 979-80. HOPKINS, *supra* note 19, at 166-68.

and nurses and purchase medical supplies from outside vendors, the symphony must pay its musicians and rent a music hall, and the soup kitchen may have to purchase food and supplies from grocery stores. This is where the concept of incidental private benefit comes into play. A charity is not prohibited from benefitting private interests through its activities so long as this benefit is incidental to the public benefit the charity seeks to accomplish.⁹²

The law relating to incidental private benefit, while longstanding, has only been more fully articulated in the last few decades through case law and IRS administrative materials.⁹³ It has essentially evolved into a two-part test: (1) whether the private benefit in question is a necessary result of the accomplishment of the intended public benefit (a qualitative test), and (2) whether the private benefit is insubstantial relative to the public benefit achieved (a quantitative test).⁹⁴ To use one of the examples described above: are the medical supplies purchased by a charitable hospital necessary to provide adequate medical care to the hospital's patients, and is the profit received by the supply vendors insubstantial relative to the medical care received by the hospital's patients? The benefit must satisfy both the qualitative and quantitative tests to be considered incidental.⁹⁵

In theory, the IRS applies the private benefit doctrine in every evaluation of a prospective 501(c)(3) organization; however, there are a number of commonly occurring scenarios

⁹² See I.R.S. Gen. Couns. Mem. 39,589 (Dec. 8, 1986); I.R.S. Gen. Couns. Mem. 39,862 (Nov. 22, 1991).

⁹³ See Jones, *supra* note 87, at 998-1001 (contending that the private benefit doctrine was "effectively ignored because it seemed only to state the obvious" until it attracted case law and IRS attention in the late 1980s).

⁹⁴ See I.R.S. Gen. Couns. Mem. 39,862 (Nov. 22, 1991). Describing a common statement of this two-part test:

Any private benefit arising from a particular activity must be "incidental" in both a qualitative and quantitative sense to the overall public benefit achieved by the activity if the organization is to remain exempt. To be qualitatively incidental, a private benefit must occur as a necessary concomitant of the activity that benefits the public at large; in other words, the benefit to the public cannot be achieved without necessarily benefitting private individuals. Such benefits might also be characterized as indirect or unintentional. To be quantitatively incidental, a benefit must be insubstantial when viewed in relation to the public benefit conferred by the activity. It bears emphasis that, even though exemption of the entire organization may be at stake, the private benefit conferred by an activity or arrangement is balanced only against the public benefit conferred by that activity or arrangement, not the overall good accomplished by the organization.

⁹⁵ *Id.*

that implicate the doctrine most directly.⁹⁶ The one most clearly applicable to organizations aspiring to engage in charitable economic development involves the instrumentality rule.

C. *The Instrumentality Rule*

The instrumentality rule provides that there are certain circumstances in which the IRS will recognize an organization as charitable even though the immediate and primary beneficiaries of its services are not members of a charitable class *so long as* the ultimate effect of the activity benefits the charitable class.⁹⁷ In these instances, the private interests benefitted are considered the “means” or “instruments” to the accomplishment of a charitable end.⁹⁸ The IRS must still be convinced, however, that the benefit to private interests in this context is necessary and insubstantial relative to the public benefit the organization hopes will result.

One well-known example of this rule is when the IRS recognized the exemption of an organization that intended to make grants to legal interns (themselves not low-income or otherwise distressed) so that the interns could provide free legal services to residents of a depressed community.⁹⁹ The organization itself did not provide services to the residents, instead relying on the interns to do so. The IRS recognized the interns as “merely the instruments by which the charitable purposes are accomplished.”¹⁰⁰ The IRS has ruled similarly in the case of an organization formed in a rural community principally to raise funds and construct a medical building to lure a doctor to a medically underserved community,¹⁰¹ and likewise in the case of an organization that purchased guaranteed student loans from banks to create a secondary market for these loans and thus indirectly increase the availability of financing to those seeking an education.¹⁰² The

⁹⁶ See, e.g., Treas. Reg. § 1.501(c)(3)-1(d)(1)(iii), ex. 3 (2008) (when the activities of an organization serve to create a market for one particular business or non-exempt organization); *Wendy L. Parker Rehab. Found. Inc. v. C.I.R.*, 52 T.C.M. (CCH) 51 (1986) (when an organization directs its services at a group of individuals who, although otherwise proper recipients of charitable services, are not numerous and undefined enough to constitute a charitable class); *Jones*, *supra*, note 87, 1003-05 (when an organization enters into a profit-sharing arrangement with a for-profit business).

⁹⁷ *HOPKINS*, *supra* note 19, at § 6.3(b) (discussing IRS decisions regarding this rule).

⁹⁸ *Id.* (citing Rev. Rul. 72-559, 1972-2 C.B. 247).

⁹⁹ Rev. Rul. 72-559, 1972-2 C.B. 247.

¹⁰⁰ *Id.*

¹⁰¹ Rev. Rul. 73-313, 1973-2 C.B. 174.

¹⁰² I.R.S. Gen. Couns. Mem. 39,685 (Dec. 10, 1987).

IRS viewed the doctor and the banks, respectively, as private instrumentalities essential to cause a desired public benefit.

III. THE 501(C)(3) JURISPRUDENCE OF CHARITABLE ECONOMIC DEVELOPMENT

Concepts like charitable purposes and the private benefit doctrine, as set forth in Section 501(c)(3) and the IRC Regulations that amplify it, are fairly abstract. These concepts are more specifically applied to organizations engaged in particular “types” of activities (e.g. housing, economic development, and healthcare) in Revenue Rulings that express the official position of the IRS on how the law applies to a particular set of facts.¹⁰³ Courts also apply these concepts through case law when an organization challenges an IRS decision.¹⁰⁴ Thus, for each “type” of 501(c)(3) organization, a unique jurisprudence develops based on relevant IRS Revenue Rulings and case law. An examination of the 503(c)(3) jurisprudence relating to charitable economic development organizations follows below.

A. “Aid to the Distressed” Rulings

The jurisprudence of precedential weight related to the most common type of charities engaging in economic development—those claiming to aid distressed people and places—is contained almost entirely in three IRS Revenue Rulings from the 1970s.¹⁰⁵ In each of these rulings, the IRS analyzed the activities of an organization seeking 501(c)(3) status based on whether it “relieve[d] the poor and distressed,” “combat[ed] community deterioration,” “eliminate[d] prejudice and discrimination,” and/or “lessen[ed] neighborhood tensions.”¹⁰⁶ These are the phrases from the IRC Regulations’ definition of “charitable” that best reflect the philanthropic objectives of place-based economic development.¹⁰⁷ They are also, not coincidentally, the phrases economic development charities routinely include as governing purposes in their charter documents.¹⁰⁸ Accordingly,

¹⁰³ See HOPKINS, *supra* note 19, app. A, at 974-76.

¹⁰⁴ *Id.*

¹⁰⁵ *Infra* text accompanying notes 110-27.

¹⁰⁶ Rev. Rul. 74-587, 1974-2 C.B. 163.

¹⁰⁷ Treas. Reg. 1.501(c)(3)-1(d)(2) (as amended in 2008).

¹⁰⁸ See, e.g., Instructions to IRS Form 1023, Part VIII, Line 6a (2006).

these three Rulings serve as the cornerstone for analyzing when economic development is “charitable.”

The Rulings are brief and do not follow a consistent or explicit analytic structure. To varying degrees, the IRS considered the condition of the community that the organization sought to serve, the particular businesses it aided, and the benefit to the community that this aid would yield. Based on this information, the IRS then provided its intuitive sense of whether this meant that private business owners or the needy would benefit more and ruled accordingly.

For example, in Revenue Ruling 74-587, the IRS recognized an organization as a 501(c)(3) charity even though a principal activity of the organization was making low-interest or long-term loans to, and equity purchases in, privately owned small businesses.¹⁰⁹ At the outset, the IRS recognized that the areas to which the organization would direct its services would be high-density urban communities inhabited mainly by those who were minorities or in other disadvantaged groups.¹¹⁰ The IRS also recognized an unmet need of the businesses the organization planned to aid and the negative impact this was having in these communities. Due to a lack of access to capital, among other conditions, “many of the businesses located in these high-density urban areas have declined or fallen into disrepair, and others have ceased to operate.”¹¹¹ As a result, the areas lacked employment opportunities for their residents.¹¹²

The IRS completed its analysis by drawing a connection between the businesses the organization would aid and the alleviation of local distress. The organization planned to consult with other anti-poverty and anti-discrimination programs in selecting recipients to coordinate its services with articulated community needs and “offer the greatest potential community benefit.”¹¹³ It would direct its aid to those businesses that had not been able to obtain financing from conventional sources and would give preference to businesses that provided training and employment opportunities for the unemployed and underemployed residents of the area.¹¹⁴ In closing, the IRS cemented its decision to approve 501(c)(3) status by invoking the instrumentality rule: “the recipients of

¹⁰⁹ Rev. Rul. 74-587, 1974-2 C.B. 162-63.

¹¹⁰ *Id.*

¹¹¹ *Id.* at 163.

¹¹² *Id.*

¹¹³ *Id.*

¹¹⁴ *Id.*

loans and working capital [who wouldn't themselves qualify for charitable assistance] are merely the instruments by which the charitable purposes are sought to be accomplished."¹¹⁵

In Revenue Ruling 76-419, the IRS came to the same conclusion about an organization that purchased blighted land in an economically depressed community, converted the land into an industrial park, and leased it on favorable terms to attract industrial businesses to move to the park.¹¹⁶ The strength of the organization's claim to charitable status followed from the nexus between the businesses it aided and the need for jobs among the community's low-income residents.¹¹⁷ To be eligible for the industrial park, businesses had to agree in the leases "to hire a significant number of presently unemployed persons in the area and to train them in needed skills."¹¹⁸ The industrial park would favor those businesses with a need for low skill workers since this was of "greater immediate benefit to the surrounding depressed community."¹¹⁹

In contrast, in Revenue Ruling 77-111, the IRS denied recognition of 501(c)(3) status to two similar organizations, both endeavoring to increase the usage of retail businesses located in communities suffering from economic decline.¹²⁰ The first organization planned to conduct what essentially amounted to advertising and marketing activities to increase patronage of local businesses.¹²¹ The second planned to facilitate construction of a retail center (including a department store and shopping mall) to stem the decline of retail shopping in the community to outlying (presumably suburban) areas.¹²² Here, the IRS concluded that "the overall thrust [was] to promote business[,]” (that is, serve private interests), "rather than to accomplish exclusively 501(c)(3) objectives” (that is, serve public interests).¹²³

But what distinguished these organizations from the ones described in the previous two Rulings? The IRS did not go

¹¹⁵ *Id.*

¹¹⁶ Rev. Rule. 76-419, 1976-2 C.B. 146.

¹¹⁷ *Id.* The area had been recognized by the U.S. Economic Development Administration as having "a high ratio of unemployed and underemployed low-income people and is an area of urban blight consisting primarily of junk yards and vacant land with little industry". *Id.*

¹¹⁸ *Id.*

¹¹⁹ *Id.*

¹²⁰ Rev. Rul. 77-111, 1977-1 C.B. 145.

¹²¹ *Id.* at 144 (providing information on the area's shopping opportunities, local transportation, and accommodations).

¹²² *Id.* at 144-45.

¹²³ *Id.*

into great detail on this point. Its principal contention was that the services provided by the organizations in Revenue Ruling 77-111 would benefit all businesses located in the community and in the retail center, respectively, without regard to whether they were “owned by minority groups” or whether they were experiencing difficulties based on their location in a deteriorated section of the community.¹²⁴ Remarkably, the Ruling makes no mention of the extent to which the jobs and economic activity associated with the aided businesses would alleviate distress in the community served.¹²⁵ The fact that the organization would aid businesses regardless of whether the businesses themselves were in some fashion distressed carried the day.¹²⁶

These three Rulings provide a rudimentary template for analyzing the type of economic development carried out by REDOs. If an organization simply promotes business activity in a community, it is not charitable even if the community is distressed (Revenue Ruling 77-111); if it tailors its assistance to businesses encountering some form of hardship or difficulty resulting from the distressed community in which they are located or seek to locate, it may be charitable depending on the circumstances (Revenue Rulings 74-587 and 76-419). No subsequent Rulings have modified these decisions, and there is no case law on the issue.

Elucidating “precedential” jurisprudence on tax law matters is publicly available non-precedential guidance that the IRS provides in the form of (1) private letter rulings (PLRs) addressed to individual people and entities that request IRS guidance on a specific issue, and (2) internal IRS office memoranda (technical advice memoranda and general counsel memoranda) on issues that the IRS determines merit the consideration of its in-house attorneys.¹²⁷ Although the Internal Revenue Code expressly prohibits reliance by the public on these non-precedential materials,¹²⁸ they are useful in understanding the IRS’s position on a particular issue, and typically contain more detail and are in much greater supply than Revenue Rulings.¹²⁹

The IRS has released numerous PLRs over the last three decades evaluating the 501(c)(3) eligibility of charitable economic development organizations and they all cite to some combination

¹²⁴ *Id.* at 145.

¹²⁵ *Id.*

¹²⁶ *Id.*

¹²⁷ See HOPKINS, *supra* note 19, app. A, at 978.

¹²⁸ I.R.C. § 6110(k)(3).

¹²⁹ See HOPKINS, *supra* note 19, app. A, at 978.

of the three 1970s era Rulings.¹³⁰ Only once, in the early 1990s in an intra-agency memorandum, did the IRS elaborate on its position. In response to a request for a private letter ruling from a business incubator offering technical, managerial, and financial assistance to businesses in a “depressed” community in America’s Rust Belt and some intra-agency disagreement as to how to evaluate it, the IRS prepared a General Counsel Memorandum synthesizing the 1970s era Rulings.¹³¹

The Memorandum is noteworthy for several reasons. First, the IRS explicitly identified the private benefit doctrine as the crucial issue in evaluating whether economic development is charitable.¹³² Second, the IRS specifically distinguished (and disapproved of) a more liberal, trickle down approach to “charitable” economic development that would recognize an organization assisting any business in a depressed area as charitable (on the theory that increased employment increases tax revenues and a general increase in business activity is itself inherently beneficial to the area). Instead, the IRS seemed insistent on a stricter nexus requirement that requires the assistance provided to link to particular problems experienced by those residing or trying to operate a business within the depressed area.¹³³ In rejecting the former and embracing the latter, the IRS made clear its concern that not limiting “charitable” assistance to those businesses achieving the greatest potential community benefit would “encourage private business development while only incidentally furthering social welfare purposes.”¹³⁴ Finally, in consolidating the 1970s era Rulings into an explicit three-factor test, the Memorandum added some detail and depth to the original analysis, including that a charitable incubator must offer its services on non-commercial terms, impose significant limitations on which geographic areas and businesses are aided and direct its services toward those recipients that will offer the greatest potential community benefit to the depressed area.¹³⁵

While this expanded analysis provided a somewhat clearer and fuller template for analyzing economic development organizations, it appears that the IRS soon after cast it aside.

¹³⁰ See, e.g., I.R.S. Priv. Ltr. Rul. 2011-35-032 (Sept. 2, 2011); I.R.S. Priv. Ltr. Rul. 2006-14-030 (Apr. 7, 2006); I.R.S. Priv. Ltr. Rul. 2004-47-048 (Nov. 19, 2004); I.R.S. Priv. Ltr. Rul. 2001-03-083 (Jan. 19, 2001).

¹³¹ I.R.S. Gen. Couns. Mem. 39,883 (Oct. 26, 1992).

¹³² *Id.*

¹³³ *Id.*

¹³⁴ *Id.*

¹³⁵ *Id.*

It was never incorporated into precedential law, nor has the IRS ever referred to it again, except in the private letter ruling that was the impetus for the memorandum.¹³⁶ Instead, subsequent IRS letter rulings only reference and reflect the more intuitive and less structured approach of the 1970s era Rulings.¹³⁷

B. *“Lessening the Burdens of Government” Rulings*

Organizations that “lessen[] . . . the burdens of government” form a second category of economic development organizations that qualify as charities.¹³⁸ This phrase also appears in the definition of “charitable” contained in the IRC Regulations.¹³⁹

Although reducing the work of the government may not comport with the common perception of charity, it is well-established under Section 501(c)(3) as a separate, independent basis for exemption.¹⁴⁰ This basis for exemption is rooted in the theory that work that lessens a governmental burden saves public money, which promotes the general welfare.¹⁴¹ The U.S. tax system does not impose income tax on state or local government branches or government instrumentalities, and donations to these public entities for public purposes are generally tax-deductible.¹⁴² Therefore, providing 501(c)(3) status for organizations that do the work of government seems equitable.

At first glance, this phrase appears to open the floodgates for many more economic development organizations to qualify under Section 501(c)(3). Economic development is a common activity for state and local governments regardless of the condition of the areas or constituents that they serve.¹⁴³ A broad interpretation of “lessening the burdens of government” could encapsulate any organization whose mission overlaps with any government function. At least conceptually, however, two significant limitations apply.

¹³⁶ See I.R.S. Priv. Ltr. Rul. 92-40-001 (May 1, 1992).

¹³⁷ See rulings cited *supra* note 130.

¹³⁸ See Instructions to IRS Form 1023, Part VIII, Line 6a (identifying which phrases included in the definition of charitable apply to economic development).

¹³⁹ Treas. Reg. 1.501 (c)(3) -1 (d)(2) (2008).

¹⁴⁰ See Internal Revenue Service, *Instrumentalities—Lessening the Burdens of Government*, 1984 EO CPE Text (1984).

¹⁴¹ H.R. Rep. No. 75-1860, at 19 (1939) (Congressional report explaining the government’s relief from financial burden as one basis for exempting charitable organizations from taxation).

¹⁴² No provision in the Internal Revenue Code imposes the federal income tax on government entities. See I.R.C. § 170 (c)(1) (allowing for deductibility of charitable contributions to political subdivisions of the United States and its states and possessions).

¹⁴³ See Luger, *supra* note 9.

First, the IRS has ruled that, to lessen governmental burdens, an organization must demonstrate that (1) a governmental unit considers the organization's activities to be the government's burden, and (2) the organization's activities actually lessen the burden of government.¹⁴⁴ In evaluating whether an organization meets this two-part test, the IRS considers multiple factors, most of which center around whether the activities the organization plans to engage in are those the government actually performed or planned to perform, and the degree of control the government will exercise over the organization's performance of those activities.¹⁴⁵ In short, the more control a governmental unit exerts over an organization (for example, through seats on its board of directors, funding agreements, and annual reporting requirements) and the stronger the evidence that the organization's specific activities replace activities that the governmental unit would otherwise have to perform (rather than activities it simply endorses or supports), the more likely the organization will be seen to be lessening the government's burdens.¹⁴⁶

Tax law of precedential weight is virtually non-existent on the question of when place-based economic development actually lessens the burdens of government. A review of non-precedential IRS letter rulings and memos, however, indicates that once an economic development organization has met the two-part test described in the previous paragraph, a very broad range of activities qualify as charitable. Examples include: using public bond proceeds to acquire and develop property that will be sold or leased to for-profit corporations to aid in their creation and expansion,¹⁴⁷ forming an innovation incubation center for commercial tenants to lure high technology companies to a state,¹⁴⁸ acquiring and leasing an office building to attract international trade business,¹⁴⁹ and even owning a Major League baseball team to keep it from leaving town.¹⁵⁰ Although most of these cases involved

¹⁴⁴ Rev. Rul. 85-2, 1985-1 C.B. 178 (1985).

¹⁴⁵ Robert Louthian & Amy Henchey, *Lessening the Burdens of Government*, 1993 EO CPE Text (1993) (listing some of the factors as interrelationship with governmental unit, activity previously conducted by governmental unit, payment of government expenses, sources of funding, and whether activity is one that could be performed directly by governmental unit).

¹⁴⁶ *Id.*

¹⁴⁷ I.R.S. Gen. Couns. Mem. 39,852 (June 19, 1991).

¹⁴⁸ I.R.S. Priv. Ltr. Rul. 2005-37-038 (Sept. 16, 2005).

¹⁴⁹ I.R.S. Priv. Ltr. Rul. 92-46-032 (Nov. 13, 1992).

¹⁵⁰ I.R.S. Priv. Ltr. Rul. 95-30-024 (July 28, 1995).

organizations serving economically distressed areas, none of the rulings were predicated solely on this finding.¹⁵¹

A second conceptual limitation is the private benefit doctrine. The IRC Regulation that applies the private benefit doctrine to all 501(c)(3) organizations makes no distinction for charities that lessen governmental burdens.¹⁵² The very limited case law on point backs up the applicability of the doctrine to these organizations.¹⁵³ In the most relevant case, a U.S. Tax Court noted that an organization that claimed to lessen governmental burdens by conducting a certification program for structural steel fabricators also lessened the burden of business owners and developers in an equivalent amount, and the organization had not demonstrated that this benefit was incidental to the public benefit achieved.¹⁵⁴ Thus, the private benefit doctrine trumped the organization's claim that it lessened the burdens of government.

One relatively early IRS general counsel memorandum took a similar approach in evaluating an economic development organization. Although finding on other grounds that the organization did not meet the test of lessening governmental burdens, the IRS noted that, even if it had, the organization would have had to have been evaluated on whether it "serve[d] public, rather than private, purposes."¹⁵⁵ In passing, the IRS noted that the organization's proposed construction of office space and facilities to lure businesses to the city that it promoted left considerable doubt that it primarily served public interests even where the goal was to increase local employment.¹⁵⁶

This memorandum stands in contrast to the approach the IRS usually takes (especially more recently), which is to almost entirely ignore the private benefit doctrine when charities engage in economic development under the guise of governmental function. In one private letter ruling, the IRS conceded that below-market rates would be given by a 501(c)(3) organization to start-up business tenants but spent virtually no time measuring the public benefit that would result or the

¹⁵¹ See I.R.S. Priv. Ltr. Rul. 2005-37-038 (Sept. 16, 2005); I.R.S. Priv. Ltr. Rul. 95-30-024 (July 28, 1995); I.R.S. Priv. Ltr. Rul. 92-46-032 (Nov. 13, 1992); I.R.S. Gen. Couns. Mem. 39,852 (June 19, 1991).

¹⁵² Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) (as amended in 2008).

¹⁵³ *Policemen's Benev. Ass'n of Richmond, Va. v. United States*, 661 F. Supp. 765, 767, 772 (E.D.Va. 1987); *Indiana Crop Improvement Ass'n, Inc. v. Comm'r*, 76 T.C. 394, 399-400 (1981); *At Cost Servs., Inc. v. Comm'r*, 80 T.C.M. (CCH) 573, 576 (2000).

¹⁵⁴ *Quality Auditing Co., Inc. v. C.I.R.*, 114 T.C. 498 (June 19, 2000).

¹⁵⁵ I.R.S. Gen. Couns. Mem. 38,693, 1981 WL 169531 (Apr. 15, 1981).

¹⁵⁶ *Id.*

segment of the public that would benefit; it stated simply that the project is “expected to provide significant employment in an underutilized area.”¹⁵⁷ In another ruling, addressing a community foundation’s purchase of the Kansas City Royals, the IRS noted that “the [f]oundation’s investment would flow through to private parties involved in the [t]eam’s operation” (including the players—most of whom received multi-million dollar salaries), but simply dismissed these benefits as “qualitatively and quantitatively incidental to the charitable purpose of lessening the burdens of government” without any further analysis.¹⁵⁸ In short, the most relevant on-point IRS rulings barely mention the private benefit doctrine or do not consider it at all.¹⁵⁹

C. Additional Regulatory Standards Pertaining to Charitable Economic Development

Although not technically applicable to most 501(c)(3) organizations, another source of standards pertinent to understanding what constitutes charitable economic development can be found in the IRC Regulations that govern program-related investment by 501(c)(3) private foundations (PRI Regulations).¹⁶⁰ The PRI Regulations reflect the IRS position on when investments by foundations in for-profit companies and other non-exempt entities for economic development purposes are charitable and are of greater authoritative weight than Revenue Rulings. Ultimately, however, the PRI Regulations in this area simply confirm the continued relevance of the 1970s-era Revenue Rulings, as the fact patterns contained in these regulations largely mirror the analysis and conclusions contained in those Rulings.¹⁶¹

¹⁵⁷ I.R.S. Priv. Ltr. Rul. 2005-37-038 (Sept. 16, 2005).

¹⁵⁸ I.R.S. Priv. Ltr. Rul. 95-30-024 (July 28, 1995).

¹⁵⁹ See I.R.S. Priv. Ltr. Rul. 2005-37-038 (Sept. 16, 2005); I.R.S. Priv. Ltr. Rul. 95-30-024 (July 28, 1995); I.R.S. Priv. Ltr. Rul. 92-46-032 (Nov. 13, 1992); I.R.S. Gen. Couns. Mem. 39,852 (June 19, 1991).

¹⁶⁰ Treas. Reg. § 53.4944-3 (2013).

¹⁶¹ Treas. Reg. § 53.4944-3(b) (2013). Very recently, the IRS, in conjunction with the U.S. Treasury Department, released proposed additions to the list of examples in the PRI Regulations. The new examples, promulgated largely to reflect that PRIs are made not just in furtherance of place-based economic development but also extend to other charitable purposes like the development of disease-fighting drugs, preservation of the environment and promotion of the arts, do not add much to understanding the specific circumstances in which the IRS views economic development as achieving charitable purposes. Prop. Treas. Reg. § 53.4944-3(b), 77 Fed. Reg. 23429, 23430-32 (Apr. 19, 2012).

IV. SHORTCOMINGS OF THE STATUS QUO

The current jurisprudence relating to charitable economic development, as summarized in Part III, and the IRS's current oversight of organizations involved in this type of work are inadequate for effectively regulating a newer breed of economic development charities exemplified by REDOs. Charitable economic development in any form presents a regulatory challenge for the IRS because the direct recipients of aid are for-profit enterprises. For-profit companies seek primarily to create wealth for their owners who are usually not members of a charitable class. Accordingly, public benefit occurs only as an indirect result of the success of the intermediary for-profit enterprises which are organized and obligated to prioritize the private benefit of their owners over the achievement of any public good.

Moreover, in contrast to other charitable "instrumentality" cases (for example, the legal interns that received grants from a charity to represent low income individuals), the accomplishment of a charitable end as a result of this type of an intermediary's acts is less immediate and even uncertain. A loan to a start-up business may allow it to purchase equipment or rent office space or pay for technical expertise vital to its reaching the next stage of development. But the payoff to a distressed community as a result of the loan in terms of new jobs, additional tax revenue, or other measurable impact may be years away or may never come at all.¹⁶² Aid to the community trickles down slowly if at all; the only certain beneficiaries are the for-profit companies.¹⁶³

These problems are only heightened as charitable economic development is increasingly carried out by organizations with a broader regional focus. As REDOs aid businesses in areas that are geographically larger and socioeconomically more diverse, determining whether, when, and how those who are worthy targets of charitable aid actually benefit becomes all the more difficult. Standing as it does in sharp contrast to more conventional charitable activity (which is typically provided directly and immediately to members of a charitable class), "charitable" economic development would seem to merit careful

¹⁶² See generally Bartik, *supra* note 9; see also Norman Krumholz, *Equitable Approaches to Local Economic Development*, 27 POL'Y STUDIES J. 83 (1999).

¹⁶³ Krumholz, *supra* note 162 at 85.

additional attention from the IRS. But this is not reflected in the current jurisprudence or IRS practices.¹⁶⁴

This article proposes that the problem with the current system has three components—(1) the current jurisprudential analytic standards for evaluating whether an economic development organization is charitable are too outdated and blunt to adequately assess contemporary organizations, (2) there is inconsistency in how rigorously even these inadequate standards are applied, and (3) the IRS has no adequate mechanism for monitoring whether an economic development organization accomplishes charitable ends after it is initially recognized as a 501(c)(3) charity. As a result, there is significant potential for organizations to benefit from the substantial tax breaks, access to funding, and societal goodwill associated with 501(c)(3) status, even though the ends accomplished by their work are not really charitable. I discuss the basis for these three concerns and the resulting harm in greater detail here in Part IV before moving on to possible solutions, further considerations, and recommendations in the sections that follow. My principal contention is that a more nuanced, consistent, and frequent application of the private benefit doctrine to all organizations engaged in charitable economic development can address all three concerns.

A. *Outdated and Blunt Analytic Standards*

The principal task of the IRS in applying the private benefit test to charitable economic development is to decipher whether, in a particular set of circumstances, the aid to businesses that an organization provides results primarily in the accomplishment of charitable or commercial objectives. Put into private benefit terminology, is the benefit resulting from the assistance rendered to the for-profit instrumentalities in fact both *insubstantial* relative to the benefit ultimately experienced by a charitable class, and *necessary* for achievement of that public benefit?¹⁶⁵ Or is it the other way around—is the charitable class merely the incidental beneficiary of the services rendered to the instrumentalities?

These questions are easier to ask than to answer. There is no fixed percentage for what constitutes insubstantiality; no uniform mechanism for quantifying benefits (some of which are monetary and some of which are not); “necessity” can be largely

¹⁶⁴ See generally *supra* Part III.

¹⁶⁵ See I.R.S. Gen. Couns. Mem. 39,862 (Nov. 22, 1991).

subjective; and even the question of when some benefits should be considered public and when they are private is debatable. The precedential jurisprudence arising from the 1970s-era Revenue Rulings fills the gaps only to an extent (and only as to the more common form of place-based charitable economic development organizations—those purporting to aid the poor and distressed). As explained in Part III, these Rulings consider, to varying degrees: (1) whether the area the charity serves is distressed, (2) the needs of the businesses it serves, and (3) the nexus between the benefits aid to those businesses will yield and the alleviation of the area's distress.¹⁶⁶ Within this loose framework, the IRS develops its hunch on whether the organization primarily serves commercial or charitable purposes.

This framework worked well enough in assessing the more obviously charitable forms of economic development conducted in the 1970s by CDCs in highly distressed neighborhoods.¹⁶⁷ But it is too imprecise for the economic development of the twenty-first century, like that conducted by REDOs. To demonstrate this, consider the example of the Business Accelerator, profiled in Part I. The organization's ultimate objective is revitalization of an economically depressed region. It seeks to accomplish this by investing seed capital in and providing technical assistance to the region's companies with the highest potential. Aside from realizing a return on its investment to satisfy stockholders, the Business Accelerator operates like a private sector venture capital firm.¹⁶⁸

The first consideration from the Rulings is whether the area the organization serves is "distressed." But what constitutes "distress"? There is no established definition for 501(c)(3) purposes. Furthermore, how much of an area must be distressed in order to qualify it as an appropriate target of charitable economic development? The economically depressed anchor city served by the Business Accelerator will likely satisfy most definitions of distressed. But what about the surrounding 15-county region? The nature of urban sprawl in present day America is that proximate to most distressed

¹⁶⁶ *Supra* Part III.

¹⁶⁷ *See supra* Part I (discussing the history of charitable economic development and community development corporations in subsections (a)-(c)).

¹⁶⁸ Venture capital firms invest in early-stage companies with high growth potential but sufficient risk that banks are not yet willing to invest. A venture capitalist typically takes a seat on the board of directors and plays a management role in companies in which it invests. *See, e.g., VC Industry Overview*, NAT'L VENTURE CAP. ASS'N, http://www.nvca.org/index.php?option=com_content&view=article&id=141&Itemid=589 (last visited Feb. 10, 2014).

urban cores is a mix of enclaves of significant wealth, and areas that are largely upper middle and/or middle-class.¹⁶⁹

The broad geographic and socioeconomic coverage of REDOs begs the question of how much of the organization's services must go toward companies in the region's highly distressed areas. REDOs like the Business Accelerator often make their investments in businesses and individuals located in the more affluent sections of the regions they serve.¹⁷⁰ As a practical matter, this makes sense given that those with the means and educational background to cultivate high-growth businesses are more likely to be found in areas of affluence than in those that are poverty-stricken.¹⁷¹ But is location proximate to an area of severe distress enough to make a business an appropriate target for charitable aid and, if so, how close must it be? What is the appropriate mix of wealth and poverty within a large region in order for businesses throughout it to be considered appropriate targets of charitable aid? The current jurisprudence, which is based on IRS rulings analyzing organizations serving highly impoverished urban neighborhoods, does not consider areas with mixed demographics.

The second jurisprudential consideration is also difficult to evaluate. Is it "necessary" that the Business Accelerator provide the companies it serves with financing and technical services in the sense that the companies would not otherwise have access to them? With an eye toward regional transformation, organizations like the Business Accelerator often target new economy companies with perceived high-growth potential, like biotechnology, software, engineering, and medical research enterprises pursuing cutting-edge technologies.¹⁷² Undoubtedly, these enterprises are much better situated to attract private sector financing than the minority-owned businesses described in

¹⁶⁹ See VEY ET AL., *supra* note 5, at 20-26 (describing how broad economic trends, locational preferences of individuals, and state policies have facilitated the migration of people, jobs, and resources toward expanding metropolitan fringes, while reinforcing the concentration of poverty and deterioration of urban cores).

¹⁷⁰ See, e.g., JUMPSTART, <http://www.jumpstartinc.org/aboutus/pressroom/pressreleases.aspx>, (last visited Feb. 10, 2014) (review of JumpStart's press releases from July 2011 to June 2012 shows it made 11 investments of \$250,000 apiece—2 of the companies invested in were located in Cleveland and Akron which have high poverty rates while remaining 9 companies were located in suburban areas).

¹⁷¹ Edward L. Glaeser et al., *Consumer City*, 1 J. ECON. GEOGRAPHY 27 (2001) (finding that high human capital workers are attracted to areas with amenities and high quality of life).

¹⁷² See, e.g., websites of REDOs identified *supra* note 11 for portfolios of companies they assist; see also e.g., IDEA FOUNDRY, <http://ideafoundry.org/portfolio> (last visited Mar. 4, 2014); HOUSTON TECH. CENTER, <http://www.houstontech.org/about-houston-technology-center/> (last visited Mar. 4, 2014).

Revenue Ruling 74-587 that were located in highly distressed neighborhoods and red-lined by local banks.

The third consideration raises even thornier questions: What is the nexus between the assistance the Business Accelerator provides to its business clients and addressing the needs of those in the community who are distressed? The 1970s-era Revenue Rulings distinguished between organizations supporting business activity in any form from those that targeted businesses that promised to hire low income or low skilled workers, or targeted entrepreneurs who were themselves low income or otherwise distressed.¹⁷³ Again, the businesses targeted by organizations like the Business Accelerator are often more sophisticated and seeking to commercialize a technology or scientific discovery.¹⁷⁴ Their founders and leadership teams consist of highly educated, highly skilled individuals whose prospects for employment elsewhere are almost certainly quite good. The short-term hiring needs of companies in these industries typically involve other highly educated, highly skilled individuals like researchers, engineers, programmers, and those with CEO/CFO experience.¹⁷⁵ Provided one of these companies ultimately proves successful and becomes fully operational, its hiring needs may change to include manufacturing, office staff, and sales positions, but the number of jobs like this that might be created can be quite speculative and even the success of these businesses is difficult to predict. Moreover, early-stage, knowledge-based companies are susceptible to being lured to other regions when subsequent funding, a buyer, or new leadership emerges elsewhere.¹⁷⁶ Is there really a close link between the types of companies that an organization like the Business Accelerator invests in and the needs of an economically distressed region's unemployed and poor residents?

Given these difficulties, how does the IRS evaluate twenty-first-century economic development? Put simply, the IRS tells its agents who review applications for recognition of

¹⁷³ See, e.g., Rev. Rul. 77-111.

¹⁷⁴ See, e.g., *supra* note 170.

¹⁷⁵ See, e.g., JUMPSTART JOB BOARD, <http://jumpstartincc.force.com/careers> (displaying current open positions at Jumpstart portfolio companies) (last visited Apr. 23, 2013).

¹⁷⁶ Chuck Soder, *Startups with Ties to Other Areas May Not Grow in Ohio*, CRAIN'S CLEVELAND BUS. (May 21, 2012), <http://www.crainscleveland.com/article/20120521/SUB1/305219980/1053/toc&Profile=1053>.

501(c)(3) status to use their intuition.¹⁷⁷ The agents are instructed to follow a “facts and circumstances” approach and exercise their judgment in determining whether “the ultimate good received by the general public outweighs the private benefit accorded to the direct beneficiaries.”¹⁷⁸ But the IRS provides no clear markers or methodology. This has historically been the policy of the IRS when it comes to most organizations that raise private benefit issues.¹⁷⁹ This approach has come under sharp criticism from commentators and scholars, who have characterized the IRS’s application of the private benefit doctrine as “pliant,”¹⁸⁰ inconsistent and inefficient,¹⁸¹ and subject to the agency’s enforcement policy whims.¹⁸²

The end result is that charities engaged in economic development do not appear to receive careful or consistent consideration under the private benefit doctrine, which is the very issue on which their 501(c)(3) status ought to turn. REDOs that invest publicly subsidized money directly into high growth potential businesses across broad and demographically diverse geographic areas are proliferating.¹⁸³ Yet how are they surviving IRS review under the 1970s era Revenue Rulings if, as the discussion above of the Business Accelerator reveals, these organizations are aiding businesses that aren’t necessarily distressed, in areas of the country that aren’t necessarily poor and are creating jobs that don’t necessarily go to the unemployed? A review of two IRS Private Letter Rulings from the past decade reveals how the current approach to evaluating economic development can lead to significantly divergent outcomes. In one case, the IRS found that an organization that offered start-up businesses below market rates at its incubator and innovation center was achieving charitable purposes simply because it was “stimulating the economy” across an entire state by aiding the growth of high-technology businesses and did so without even a mention of the private benefit doctrine.¹⁸⁴ In another case, the IRS rejected the

¹⁷⁷ See Robert Louthian & Marvin Friedlander, *Economic Development Corporations: Charity Through the Back Door* (1992 EO CPE Text), <http://www.irs.gov/pub/irs-tege/eotopicg92.pdf>.

¹⁷⁸ *Id.*

¹⁷⁹ Megosh et al., *Private Benefit Under IRC 501(c)(3)* (2001 EO CPE Text), <http://www.irs.gov/pub/irs-tege/eotopic01.pdf>.

¹⁸⁰ HOPKINS, *supra* note 19, at 20.11(b).

¹⁸¹ Jones, *supra* note 87, at 1005-06.

¹⁸² Colombo, *supra* note 86, at 1079.

¹⁸³ See *supra* notes 11, 15.

¹⁸⁴ I.R.S. Priv. Ltr. Rul. 200537038 (Sept. 16, 2005).

claim for charitable status of an organization assisting merchants to promote their businesses in an area of a community designated by the government as “distressed” because “that assistance is not limited to businesses experiencing difficulty” and includes some businesses that are “making money and are viable” and based its conclusion squarely on the private benefit doctrine.¹⁸⁵

It is difficult to extrapolate a consistent principle from the current landscape. Based on the facts in recent IRS Private Letter Rulings, one might conclude that the IRS prefers organizations that provide businesses with capital infusions and incubator space over those that offer advertising and marketing assistance, and prefers aid to start-up and technology companies over aid to merchants.¹⁸⁶ But these distinctions seem arbitrary if the purpose of the private benefit doctrine in this context is to clarify those scenarios in which aid to private businesses primarily benefits the businesses and their owners and those in which this aid primarily benefits the community the organization aspires to serve. What does seem clear is the need for more meaningful, consistent, and up-to-date standards applying the private benefit doctrine to charitable economic development.

B. Inconsistent Application of Analytic Standards

In addressing the shortcomings of the current standards above, I singled out IRS treatment of economic development organizations that base their claim to charitable status on providing aid to the distressed. As Part III explained, another category of 501(c)(3) economic development organizations rely also or, in some cases, exclusively on the claim that they are “lessening the burdens of government.”¹⁸⁷ In theory, a 501(c)(3) organization must satisfy the private benefit doctrine irrespective of which phrase it relies upon. In reality, however, the IRS applies the private benefit doctrine even less carefully and consistently to organizations that “lessen governmental burdens” than it does to organizations “seeking to aid the distressed.”

Recall the example of the Regional Advocate, another one of the modern day REDOs profiled in Part I. This organization’s

¹⁸⁵ I.R.S. Priv. Ltr. Rul. 200447048 (Nov. 19, 2004).

¹⁸⁶ I.R.S. Priv. Ltr. Rul. 201135032 (Sept. 2, 2011); I.R.S. Priv. Ltr. Rul. 200537038 (Sept. 16, 2005); I.R.S. Priv. Ltr. Rul. 2006 14030 (Apr. 7, 2006); I.R.S. Priv. Ltr. Rul. 200447048 (Nov. 19, 2004).

¹⁸⁷ *Supra* Part III.B.

primary objective is the creation of high-quality, high-wage jobs in an already up-and-coming region. Its activities consist of assembling relocation packages to get companies to move to the region, pursuing marketing initiatives touting the region and its businesses, and spearheading legislative agendas to create an environment that is even more business friendly. The Regional Advocate has elected public officials on its board of directors, gets one half of its funding from public sources, and engages in the types of marketing and business-attraction activities that state and local governments around the country are increasingly undertaking. Thus, it can legitimately claim that it lessens governmental burdens.

But how does an organization like this satisfy the private benefit doctrine? The geographic area it serves is prosperous. Every aspect of its programming involves providing direct support to individual businesses and/or the business community in general, but without any mention of distress or need encountered by those businesses. Moreover, its programs are focused more on attracting businesses from elsewhere than creating new businesses from within. An organization like the Regional Advocate would likely assert that it serves public interests by relieving municipal governments in the region of the costs associated with engaging in their own individual economic initiatives and aiding its growing population by making high wage jobs available. But how do these “public” benefits measure up against the substantial amount of financial, marketing, and legislative assistance that the organization provides to already functional businesses? What about the countervailing interests of other regions (quite possibly distressed regions in other parts of the country or world) whose companies and jobs are being lured away by the organization? Did the crafters of the Tax Code really intend to incentivize job poaching through the charitable subsidy?

As explained in Part III, the answer is that the IRS typically expends very little, if any, effort applying the private benefit doctrine to organizations like the Regional Advocate. A review of IRS private letter rulings and General Counsel memoranda evaluating economic development organizations that claim to lessen governmental burdens backs up this contention.¹⁸⁸ Moreover, the IRS has explicitly chided itself for

¹⁸⁸ See generally I.R.S. Priv. Ltr. Rul. 200537038 (Sept. 16, 2005); I.R.S. Priv. Ltr. Rul. 9530024, 1995 WL 45044 (July 28, 1995); I.R.S. Priv. Ltr. Rul. 9246032 (Nov. 13, 1992); I.R.S. Gen. Couns. Mem. 39,852 (July 1, 1991); I.R.S. Gen. Couns. Mem. 38,693 (Apr. 15, 1981).

not scrutinizing private benefit implications closely enough when organizations claim to lessen the burdens of government. Training materials for its own agents state that

often neglected in lessening the burdens cases is a consideration of the private interests served by the organization's activities; irrespective of whether an organization's activities lessen the burdens of government, the organization must still demonstrate that its activities serve a public rather than a private interest within the meaning of Reg 1.501(c)(3)-(d)(1).¹⁸⁹

Published IRS rulings subsequent to this self-reprimand give no indication that IRS agents have followed this directive.¹⁹⁰ It is hard to blame the agents, however. If the private benefit standards that apply to economic development organizations that "aid the distressed" can be described as rudimentary, those that apply to organizations that "lessen the burdens of government" are virtually nonexistent. There is no equivalent in these cases to the 1970s-era Revenue Rulings. When the private benefit doctrine is mentioned at all in lessening the burdens of government cases, the letter rulings make only vague references to ensuring that public benefit predominates over private benefit with little hint of how to measure one relative to the other. In its training materials, the IRS does no more than direct its agents to cases in which other agents engaged in an intuitive balancing of public and private benefit.¹⁹¹ The IRS lacks a consistent (or perhaps any) approach for evaluating REDOs that claim to lessen governmental burdens on an issue that should be critical to their 501(c)(3) eligibility.

C. Inadequate Mechanisms for Ensuring Ongoing Compliance

IRS scrutiny of 501(c)(3) organizations is heavily front-loaded. Most organizations that seek 501(c)(3) status must submit an application on Form 1023 to the IRS which will be reviewed by one of the agency's exempt organizations

¹⁸⁹ Louthian & Henchey, *supra* note 145, 1993 EO CPE Text (1993), www.irs.gov/pub/irs-tege/eotopicb93.pdf.

¹⁹⁰ *See, e.g.*, I.R.S. Priv. Ltr. Rul. 200537038 (Sept. 16, 2005) (reasoning that a foundation serves public interest because of its charitable purposes, with minimal discussion of the private benefit doctrine); I.R.S. Priv. Ltr. Rul. 9530024 (July 28, 1995) (concluding private benefit is incidental to the purpose of lessening the burden of government although it overlooked the pertinent principles of the private benefit doctrine).

¹⁹¹ Louthian & Henchey, *supra* note 145, at 1993 EO CPE Text, www.irs.gov/pub/irs-tege/eotopicb93.pdf; Andrew Mergosh, Lary Scollick, Mary Jo Salins and Chevy Chasin, *Private Benefit Under 501(c)(3)*, 2001 EO CPE Text (2001).

specialists to determine if the organization will operate within the limits of Section 501(c)(3).¹⁹² One of the questions on the application is specifically directed at organizations that will engage in economic development and asks the applicant to explain who will benefit from these types of activities and how they will further charitable purposes.¹⁹³ However, organizations typically apply for 501(c)(3) status before they begin to operate or at a nascent stage and, therefore, their responses related to program services are often prospective.¹⁹⁴ As a result, to the extent the IRS questions a REDO on how it will satisfy private benefit concerns, the organization's responses are based on what it thinks its activities will be and what it hopes these activities will accomplish.

If the IRS issues a determination letter to the organization recognizing its exempt status, the organization can rely on this indefinitely.¹⁹⁵ There is no formal mechanism by which the organization must periodically reestablish the basis for its exempt status. Thus, most organizations are granted tax-exempt status on the basis of largely aspirational and non-specific projections about their programming and never again separately questioned about it.

It is true that most 501(c)(3) organizations must also submit annual information returns to the IRS. The return contains financial and factual information related to the operations of the organization.¹⁹⁶ This document is used by government officials, prospective contributors, the media, and others to evaluate the overall finances, operations, and merits of an exempt organization.¹⁹⁷ However, although the IRS may use information contained in an organization's Form 990 as the basis for investigating the organization, Form 990 is principally a public disclosure document. Due to limited staffing, the IRS Tax Exempt Division typically reviews less than two percent of the 990s it receives¹⁹⁸ and audits returns at a rate of one-third of one percent.¹⁹⁹

¹⁹² I.R.C. § 508(a) (2006).

¹⁹³ I.R.S. Form 1023, Part VIII, questions 6a and 6b.

¹⁹⁴ See I.R.S. Publication 557 (2013). Because most organizations must receive a determination letter before they can take advantage of the tax and funding benefits associated with 501(c)(3) status, organizations typically apply soon after incorporating.

¹⁹⁵ See HOPKINS, *supra* note 19, at 806-07.

¹⁹⁶ I.R.S. Form 990 (2013).

¹⁹⁷ HOPKINS, *supra* note 19, at 810.

¹⁹⁸ See Fishman, *supra* note 20, at 581.

¹⁹⁹ Roger Colinvaux, *Charity in the 21st Century: Trending Toward Decay*, 11 FLA. TAX REV. 1 (2011).

Moreover, although the Form 990 requests detailed information on certain aspects of an organization's operations that are particularly likely to raise hot button legal compliance issues—such as executive compensation, transactions with organizational insiders, and lobbying activities—the Form requires little detail on the foundational issues of how an organization conducts its programs and who specifically it serves.²⁰⁰ The Form asks only one direct question about an organization's program services during the previous year.²⁰¹ In answering this question, organizations are directed by the IRS Form 990 instructions to briefly describe the programs and provide specific measurements of its accomplishments, like the number of "clients served" and "sessions or events held."²⁰² But no more is required in terms of factual details. In fact, most organizations are fairly strategic in how they respond to this question, recognizing that their Form 990 is open to public inspection.²⁰³ Many respond simply with a sentence or two description of each program service.²⁰⁴ From a 501(c)(3) engaged in economic development, the Form requires no information regarding the specific companies served by this type of organization, how the assistance the organization provided aided those in the region served who needed assistance, and/or how the assistance received by the businesses served was incidental to (that is, insubstantial relative to and necessary for) the achievement of public benefit.

The end result is that the IRS's only significant investigation of the link between who benefits from an organization's activities and its proclaimed exempt purposes is usually completed when the organization initially files an application for 501(c)(3) status. For the many 501(c)(3) organizations engaged in conventional charitable activities that involve the direct and immediate provision of aid to members of an obvious charitable class, this method of regulation is not problematic and is sensitive to IRS resource limitations. But it is not effective for monitoring economic development organizations.

It is easy for organizations to project the anticipated public benefit that will result from investments in private

²⁰⁰ I.R.S. Form 990, Part VII (2013).

²⁰¹ I.R.S. Form 990, Part III, question 4.

²⁰² I.R.S., *Instructions for Form 990 Return of Org. Exempt from Income Tax* (Dec. 2, 2013), available at <http://www.irs.gov/pub/irs-pdf/i990.pdf>.

²⁰³ I.R.S. Form 990 (in top right corner, the form states "Open to Public Inspection").

²⁰⁴ See, e.g., GREATER PHOENIX ECON. COUNCIL (I.R.S. Form 990 at 2) (2010) (answering question 4 with only two sentences).

businesses, but much harder to ensure that these projections come to fruition. Public sector programs that aid private businesses often demand accountability for the tax breaks and publicly financed loans they provide, sometimes even requiring that businesses return a portion of the aid they receive if results don't meet the initial projections.²⁰⁵ The IRS, on the other hand, has no mechanism for evaluating whether charitable economic development organizations come close to appropriately balancing the achievement of public and private benefit once they become operational. In other words, there is no long-term accountability with respect to the very issue that makes economic development organizations a regulatory challenge and worthy of special attention.

D. The Harm in the Status Quo

My critique up until this point has focused on arguing how the IRS's current approach fails to adequately evaluate which nonprofit organizations engaged in economic development satisfy private benefit concerns and, thus, are really charitable. It is fair at this point to ask the question, "So what?" After all, the other 28 subchapters of Section 501(c) allow a broad range of nonprofit organizations other than charities to qualify for exemption from income tax.²⁰⁶ Almost all REDOs could achieve tax exemption under Section 501(c)(4) as organizations that operate "for the promotion of social welfare" by satisfying far less exacting standards than apply under Section 501(c)(3).²⁰⁷ Thus, what is the real harm associated with the IRS's current lack of precision and rigor in scrutinizing those seeking to be economic development charities?

While multifaceted, the "harm" is linked to the consequences of an IRS determination that an organization qualifies as a 501(c)(3), as opposed to another type of tax-exempt entity. The law at all levels uniquely privileges nonprofit organizations engaged in charitable work.²⁰⁸ While commentators

²⁰⁵ Steve Lerch, *Economic Development Accountability Laws*, WASH. ST. INST. FOR PUB. POL'Y 1, 1 (2004) (summarizing different types of economic development accountability legislation city and state governments have passed to ensure that incentives provided to businesses meet desired economic development goals).

²⁰⁶ I.R.C. § 501(c) (2012).

²⁰⁷ I.R.C. § 501(c)(4) (2012).

²⁰⁸ JOINT COMM. ON TAXATION, HISTORICAL DEVELOPMENT AND PRESENT LAW OF THE FEDERAL TAX EXEMPTION FOR CHARITIES AND OTHER TAX EXEMPT ORGANIZATIONS 155-58 (2005) (describing tax and non-tax benefits at federal, state, and local levels associated with 501(c)(3) status).

have offered multiple theories for why that is, an overlapping theme is that charities undertake tasks widely accepted as meritorious and beneficial to society, but which the private sector and/or the government are unable or unwilling to perform.²⁰⁹ Accordingly, our society at large chooses to subsidize and incentive the performance of charitable work through laws that provide tax incentives, regulatory exemptions, and myriad other privileges unique to 501(c)(3)s that, when taken together, amount to a sizeable subsidy.²¹⁰ The IRS, through its authority to determine which organizations qualify under Section 501(c)(3), unlocks the door to these privileges and, thus, bears the responsibility of safeguarding America's charitable subsidy.²¹¹ Imprecision in carrying out this responsibility leads to misuse of the subsidy.

This misuse manifests in several different ways. A straightforward and significant example is in the tax deduction that Section 170 of the Internal Revenue Code provides to individual and corporate taxpayers who make contributions to 501(c)(3) organizations.²¹² Subject to certain limitations, the deduction allows donors to deduct the value of their contributions from their taxable income.²¹³ The estimated five-year cost of this deduction is \$246.1 billion.²¹⁴ This cost is borne by all U.S. taxpayers because tax dollars foregone through the deduction must be offset by other tax revenue. The greater the imprecision in determining 501(c)(3) eligibility, the larger the portion of this taxpayer-financed subsidy that is being misspent on and incentivizing activity that is not really charitable.

The same point can be made with respect to the other exemptions and privileges that federal law ties to 501(c)(3) status, including (to name just a few) exemption from federal unemployment taxes, the eligibility to issue tax-exempt bonds,

²⁰⁹ See, e.g., JAMES J. FISHMAN & STEPHEN SCHWARZ, *NONPROFIT ORGANIZATIONS* 297-313 (4th ed. 2010) (summarizing the major theories which explain the rationale for charitable tax advantages); see also *Bob Jones Univ. v. United States*, 461 U.S. 574, 591 (1983) ("Charitable exemptions are justified on the basis that the exempt entity confers a public benefit—a benefit which the society or the community may not itself choose or be able to provide . . .").

²¹⁰ *Bob Jones Univ.*, 461 U.S. at 591 ("When the Government grants exemptions or allows deductions all taxpayers are affected; the very fact of the exemption or deduction for the donor means that other taxpayers can be said to be indirect and vicarious 'donors.'").

²¹¹ *Id.* at 596-97.

²¹² See I.R.C. § 170 (2006).

²¹³ *Id.*

²¹⁴ JOINT COMM. ON TAXATION, *ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2010-2014* 45-48 (2010).

and preferred postal rates.²¹⁵ It also applies to the ripple effect that an organization's 501(c)(3) status has at the state and local levels: exemption from state and municipal income tax in many jurisdictions is tied to 501(c)(3) status, as is eligibility for many types of grants and contracts and, as at the federal level, a wide array of other exceptions, exemptions, and privileges.²¹⁶

Moreover, this imprecision has resulted to some degree in the over-recognition of economic development organizations under Section 501(c)(3) and, thus, overspends the charitable subsidy. This is clearly the case for organizations that claim to lessen governmental burdens, as the IRS has failed to utilize the private benefit doctrine to filter out otherwise qualifying organizations. It is probably also true for organizations that claim to aid the distressed, as evidenced by the recent proliferation of REDOs serving large geographic areas that are often not predominantly distressed.²¹⁷

The consequences of misuse, however, go beyond simply misdirecting and/or over-spending the charitable subsidy. In some cases, the availability of a particular component of the charitable subsidy is limited and, thus, its support of non-charitable activities comes at the expense of support for activities that are charitable. One example of this is grant-making by charitable foundations, which is a substantial and increasing source of support for economic development organizations.²¹⁸ In the aggregate, around 14% of all contributions (approximately \$41 billion) to 501(c)(3) organizations come from private foundations which are obligated to expend their funds in support of charitable purposes.²¹⁹ Because most foundation trustees view preservation of the foundation's assets for future use as a part of their "duty of care," most foundations limit their annual grant-making and other payouts to five percent of their assets, the minimum payout required by the Internal Revenue Code for charitable

²¹⁵ JOINT COMM. ON TAXATION, *supra* note 208, at 155-58.

²¹⁶ *Id.*

²¹⁷ *See supra* notes 11, 15 and accompanying text.

²¹⁸ *See, e.g.,* THE FOUND. CTR., *supra* note 13 (showing a 152% increase in economic development grantmaking between 2005 and 2011, and also showing that, as a share of total giving in Ohio, economic development grants doubled, from 7% to 14% between 2005 and 2008).

²¹⁹ GIVING USA FOUND., GIVING USA 2011 EXECUTIVE SUMMARY: THE ANNUAL REPORT ON PHILANTHROPY FOR THE YEAR 2010 4 (2011) (showing private foundations contributed about \$41 billion to 501(c)(3) organizations in 2010, which accounted for 14% of all contributions); AM. CITY BUREAU, INC., OVERVIEW OF GIVING USA 2009 KEY FINDINGS (2009) (showing private foundations contributed about \$41 billion to 501(c)(3) organizations in 2008, which accounted for about 13% of all contributions).

foundations.²²⁰ Accordingly, the pool of foundation grants available annually to 501(c)(3) organizations is limited and grants that are made in support of non-charitable activities necessarily decrease the amounts available for charitable activities. In real terms, grants supporting REDOs that invest in businesses may come at the expense of grants available for more conventional charitable organizations like food banks, community health centers, and afterschool arts programs.²²¹ This is not a problem if REDOs are properly scrutinized for 501(c)(3) qualification, but it opens the door for a significant diversion of funding intended for charitable purposes if they are not.

This diversion may negatively impact not only charities, but for-profit businesses as well. Access to capital and the costs associated with technical assistance and basic infrastructure present huge challenges for most startup companies. Organizations like REDOs utilize the charitable subsidy to help certain companies overcome these challenges by providing financing, office space, other forms of expertise, and infrastructure below cost or, in some cases, at no cost. Undoubtedly, this gives the businesses that are assisted a huge leg up over competing firms. Again, if REDOs are properly scrutinized to ensure a strong nexus between the businesses they aid and the accomplishment of charitable purposes, this leg up should be fully consistent with the purpose of subsidizing charitable organizations. But if the activities of the organization are not rigorously reviewed, businesses whose success bears little connection to the accomplishment of charitable purposes will benefit unjustifiably relative to all other businesses (not only those whose success would accomplish charitable purposes, but also those which simply face existing barriers to entering the marketplace without taxpayer funded assistance).

In summary, the chief function of the IRS as it relates to the charitable sector is to monitor who qualifies for 501(c)(3) status to assure the public and donors that the charitable subsidy is

²²⁰ COMMONFUND INST., PRINCIPLES OF NONPROFIT INVESTMENT MANAGEMENT 11 (2005), *available at* https://www.commonfund.org/_catalogs/masterpage/principlesofnonprofitinvestmgmt.pdf; AKASH DEEP & PETER FUMPKIN, THE FOUNDATION PAYOUT PUZZLE 11 (2001), *available at* http://www.hks.harvard.edu/hauser/PDF_XLS/workingpapers/workingpaper_9.pdf.

²²¹ *Compare* FOUND. CTR., *supra* note 13, with FOUND. CTR., SPOTLIGHT ON ECONOMIC DEVELOPMENT GRANTMAKING IN OHIO (Feb. 2008), http://foundcenter.org/gainknowledge/research/pdf/spotlight_ohio_2008.pdf (showing that the increase in economic development grantmaking as a share of total giving in Ohio between 2005 and 2008 resulted in a corresponding decrease in the percentage of grant dollars used for other purposes).

utilized for legitimate charitable purposes as the law has defined them. Where the potential for significant misuse of this subsidy exists, the IRS, Congress, or the courts must step in to address it.

V. CRAFTING A SOLUTION FOR MORE EFFECTIVE
REGULATION OF CHARITABLE ECONOMIC DEVELOPMENT

A. *The Merits of a Well-Tailored Private Benefit Doctrine*

This article's principal contention is that a more nuanced, consistent, and frequent application of the private benefit doctrine to organizations engaged in charitable economic development can help resolve all three of the concerns raised in the previous section and better protect the charitable subsidy. Calling upon the private benefit doctrine to add clarity to the regulation of any category of 501(c)(3) organizations might at first seem like a questionable proposition. The language serving as the basis for the doctrine is awkwardly written and lacks well-established theoretical boundaries to guide its application.²²² The IRS Exempt Organizations Division—the very department charged with enforcing the doctrine—concedes that it can be difficult to apply as “decided cases provide only broad bench-marks, with the result that the relevant facts in each individual case must be strained through those [established] principles to arrive at a decision on the particular case.”²²³ Commentators and scholars have frequently battered the doctrine and its application by the IRS,²²⁴ with some arguing that it should be reined in or even abandoned altogether.²²⁵

Rather than throwing the private benefit doctrine under the bus, however, it is worth noting that no one who criticizes the doctrine really finds fault with the general premise that in order for an organization to merit the charitable subsidy it must primarily serve public interests.²²⁶ Criticism focuses instead on how the doctrine is applied. Some question the recent significant increase in the number of situations in which the IRS invokes the doctrine, asserting that the malleability of the doctrine

²²² See Colombo, *supra* note 86, at 1080 (“Indeed, the problem is that the doctrine currently has no theoretical grounding to set its outer boundaries.”); see also HOPKINS, *supra* note 19, at 540.

²²³ Megosh et al., *supra* note 179, at 140 (internal citations and quotation marks omitted).

²²⁴ HOPKINS, *supra* note 19, at 540; Jones, *supra* note 87, at 1002-05.

²²⁵ See Colombo, *supra* note 86, at 1065 (“In the past, I have expressed my displeasure with the private benefit doctrine in writing, explicitly calling for its demise.”).

²²⁶ See Jones, *supra* note 87, at 998; see also Colombo, *supra* note 86, at 1067.

allows the IRS to mold it to serve as a basis to oppose every new interaction between a nonprofit and a private party that it does not like.²²⁷ Others criticize the discretion the test provides to IRS agents to grant or deny organizations 501(c)(3) status without reference to a guiding principle. In words that aptly sum up this point, one scholar referred to it as the “quintessential balancing test under which the IRS both owns and reads the scale, leaving charities completely at sea regarding the possible ill effects of transactions with for-profit intermediaries.”²²⁸

While conceding that the above are valid criticisms, I contend that the private benefit doctrine, when properly refined and articulated, could serve as a clear and consistent tool for the IRS to use in evaluating newly emerging types of charities (like REDOs) in a vastly changing nonprofit world that more closely resembles the private sector. The size, sophistication, and scope of nonprofit organizations have increased significantly in the last several decades.²²⁹ A combination of increased responsibility caused by the government’s gradual withdrawal from the direct provision of social services, increased competition for dwindling public sector and philanthropic dollars, and the increased professional credentials of those working within the nonprofit sector has resulted in an industry that is on the whole more self-sufficient, ambitious, and entrepreneurial.²³⁰ This, in turn, has increased the influence of the private sector on how charities operate. In the twenty-first century, nonprofits view fees charged for services as an essential source of operational income; create for-profit and nonprofit subsidiaries to partner with private sector property developers and operate business ventures; enter into complicated capital-raising vehicles in cooperation with investment banks; and transfer valuable rights in technology, research, and other intellectual property to private companies with the capacity to commercialize these assets and generate vast sums of profit.²³¹

²²⁷ See HOPKINS, *supra* note 19, at 540 (b).

²²⁸ Colombo, *supra* note 86, at 1065.

²²⁹ Alan J. Abramson & Rachel McCarthy, *Infrastructure Organizations*, in THE STATE OF NONPROFIT AMERICA, 423 (Lester M. Salamon ed., 2002).

²³⁰ See generally Gerry W. Jenkins, *Who’s Afraid of Philanthro-capitalism*, 61 CASE W. RES. U. L. REV. 753, 755 (2011) (describing recent pressures on nonprofit sector to become more like private sector in its “capacity, efficiency, accountability and effectiveness”).

²³¹ See Barbara K. Bucholtz, *Doing Well By Doing Good and Vice Versa: Self Sustaining NGO/Nonprofit Organizations*, 17 J. L. & POL’Y 403, 424-33 (2009); see also Kelley, *supra* note 26, at 2438-39 (discussing how nonprofits are expected to operate like successful commercial enterprises).

These are developments the IRS probably did not foresee in 1959 when the language providing the basis for the private benefit doctrine was formally adopted into the IRC Regulations. And yet, this doctrine, among all of the other language contained in Section 501(c)(3) and the IRC Regulations, appears to be the most salient to the very concerns raised as the private sector becomes increasingly intertwined with the charitable domain. Its broad wording makes it potentially adaptable to addressing unforeseen issues in an ever more complex nonprofit world.

At the same time, there reaches a point when, as it pertains to a particular category of 501(c)(3) organizations, the facts and circumstances, gut-reaction style approach that the IRS takes in applying the private benefit doctrine fails to adequately regulate. When this approach leads to differing results among similar organizations, does not provide adequate guidance on which activities fall outside the definition of charitable, or fails to ensure sufficient accountability, it must be refined so that the doctrine better addresses the unique issues raised by that subset of organizations. It is at this point that Congress, the IRS, or the courts must step in to clarify and sharpen the jurisprudence and/or reform the way the doctrine is being applied. This has happened on several occasions in the last decade, including for hospitals,²³² private-sector joint ventures,²³³ credit counseling organizations,²³⁴ and housing down payment providers.²³⁵ The time has arrived for it to happen for economic development organizations as well.

B. Possible Strategies

Of course, the harder task is not acknowledging that the private benefit doctrine must be better tailored for economic development organizations, but determining how to do so. There are a wide range of possible strategies, most of which would require congressional legislation to amend Section 501 of the Internal Revenue Code, an amendment to Treasury Department regulations, an IRS Revenue Ruling, or a combination of these. These possibilities (none of which are mutually exclusive) include:

²³² I.R.C. § 501(r) (2010).

²³³ Rev. Rul. 98-15, 1998 C.B. 718 (Mar. 23, 1998).

²³⁴ I.R.C. § 501(q) (2010).

²³⁵ Rev. Rul. 2006-27, 2006-21 I.R.B. 915, 2006-I.C.B. 915.

1. Modernizing and Refining Jurisprudential Standards

One obvious fix would be to modernize the standards set forth in the 1970s-era Revenue Rulings. Through a Revenue Ruling, the IRS could update these standards to clarify what constitutes a distressed area, more fully define the types and amounts of public benefit that must follow from aid to businesses, and/or more explicitly characterize the required link between the aid provided by organizations and the needs of the businesses aided. Doing so would provide aspiring 501(c)(3) organizations and the IRS with clearer, more relevant standards.

Of course, the IRS would face some hard choices in deciding how to refine those standards. Should the standards be more quantitative (for example, by imposing fixed thresholds like the percentage of jobs created that must be filled by low-income people who reside within an organization's service area), more qualitative (for example, by more explicitly defining a distressed area or an appropriate charitable class for economic development purposes) or a combination of the two? The type of economic development an area needs depends on the challenges it faces. Would more refined standards apply uniformly or would they vary relative to specific socio-economic challenges faced by the population served, indicators of distress, or some other factor? Would standards vary according to the activities engaged in by an organization (for example, should an organization face job creation thresholds that are tied specifically to the amount of money it invests in for-profit enterprises)?

These questions raise the larger issues of the extent to which concepts like private and public benefit can even be accurately measured, and whether imposing more narrowly defined standards could actually result in excluding some organizations that accomplish charitable ends. Finally, how and to what extent would these standards apply to economic development organizations that seek charitable status by claiming to lessen the burdens of government? Would a separate set of standards need to exist for these organizations and on what basis would it be formulated?

2. Allowing Organizations to Formulate Their Own Private/Public Benefit Standards

An alternative to formally and uniformly changing the current IRS standards is to allow each economic development organization seeking 501(c)(3) status to devise its own

standards for accomplishing the appropriate balance between public and private benefit and to justify them in its application for recognition of 501(c)(3) status. This strategy recognizes that economic development encompasses many different types of activities in many different contexts and, thus, a one-size-fits-all solution may not be adequate. Great Britain uses this approach in regulating its equivalent of charitable economic development organizations.²³⁶

Although subject to the risk that an organization will only craft a standard that it will meet, the fact that the organization would have to explain and defend its standard in its 1023 application ensures that the IRS would at least have an opportunity to scrutinize the organization's methodology. This concern could also be addressed by requiring that the organization provide objective data and/or third-party opinions substantiating the validity of its standards.

3. Regulating Board Composition to Incorporate Interests of the Charitable Class

An even more indirect method of addressing the concerns identified in Part IV would be to require that the board of directors (Board) of 501(c)(3) economic development organizations consist of a majority of individuals selected from the charitable class that the organization intends to serve. Harkening back to the model utilized in Community Economic Development, the reasoning is that a Board that is representative of a charitable class will be less likely to stray from the underlying mission of serving that class.²³⁷ In isolation, this strategy involves neither change to the current substantive standards comprising the private benefit doctrine nor any increased role for the IRS. Instead, it relies heavily on the Board—the constituent body charged with stewardship of an organization's charitable mission—to exercise judgment in striking the right balance between the public and private benefit generated by the organization's activities.²³⁸

²³⁶ *The Review of the Register of Charities: Promotion of Urban and Rural Regeneration*, Charity Commission (Mar. 1999), <http://www.charitycommission.gov.uk/media/95169/rr2text.pdf>.

²³⁷ See Clark, *supra*, note 43.

²³⁸ Members of nonprofit Boards of Directors owe a duty of obedience to carry out the purposes of the organization as expressed in its articles of incorporation. FISHMAN & SCHWARZ, *supra* note 209, at 198.

Congress recently utilized a similar type of an approach for 501(c)(3) and 501(c)(4) organizations engaged in credit counseling out of a concern that these organizations often operate primarily to further the interests of for-profit companies to which the organizations refer their clients.²³⁹ Congress added 501(q) to the Internal Revenue Code requiring that the Boards of credit counseling organizations be “controlled” by “persons who represent the broad interests of the public,” and limiting how many Board members can be employed by the organization or financial beneficiaries of its activities.²⁴⁰

4. Requiring Periodic Board Certification of Adequate Public Benefit

This is another strategy that utilizes an economic development organization’s Board to ensure that the organization satisfies the private benefit doctrine. In this case, a Board would be required to periodically review the activities of the organization and determine whether these activities yield the appropriate balance between public and private benefit. Each Board member would then have to certify or dissent from a statement that, in the Board’s opinion, the organization strikes an appropriate balance. The organization would disclose the results of this certification process on its annual Form 990.

This approach most closely reflects the spirit of Sarbanes-Oxley reforms for publicly traded corporations²⁴¹ and it reinforces provisions in the IRS model conflict-of-interest policy for Board members of 501(c)(3) organizations.²⁴² The onus is clearly on individual Board members to participate in due diligence on an organization’s business assistance programs and to understand the relevant jurisprudence of the private benefit doctrine in order to have a reasonable basis for making the certification. However, as with the immediately preceding strategy, one might fairly question whether individual Board members will have sufficient time and legal acumen to effectively make these types of assessments.

²³⁹ I.R.C. § 501(q) (2010).

²⁴⁰ I.R.C. § 501 (q)(1)(D) (2010).

²⁴¹ See A.B.A. COORDINATING COMM. ON NONPROFIT GOVERNANCE, GUIDE TO NONPROFIT CORPORATE GOVERNANCE IN THE WAKE OF SARBANES-OXLEY 5-6 (2005).

²⁴² See I.R.S., Instructions for Form 1023, Article VI (2013).

5. Expanding Disclosure Requirements on the Annual Information Return

The IRS could revise Form 990 to elicit more specific information from economic development organizations about their activities, including the names, types, and locations of businesses they assist; the forms of aid they provide; the number and types of jobs this aid creates; and other information relevant to understanding the relative public and private benefit generated by the organization's activities. Form 990 currently contains several schedules to the main form designed specifically for the purpose of gathering additional information from particular types of organizations that implicate regulatory concerns.²⁴³ For example, Schedule H to Form 990 requires more detailed responses from hospitals about the amount of charitable care and types of community benefits they provide.²⁴⁴ This type of requirement for economic development organizations would ensure that the IRS, the general public and funders have detailed, consistent and up-to-date information that serves as a basis for evaluating if an organization satisfies the private benefit doctrine and, in this way, increases the organization's general accountability as it relates to this issue. However, it does not necessarily increase the likelihood that the IRS will make use of this data, as the agency only examines a very small percentage of the 990s it receives.²⁴⁵

6. Providing for Periodic IRS Review of an Organization's 501(c)(3) Status

A more direct way of increasing accountability would be to mandate that the IRS periodically review the 501(c)(3) status of every economic development organization. This strategy recognizes that the IRS can make a more accurate assessment of how an organization complies with the private benefit doctrine retrospectively, on the basis of actual data

²⁴³ I.R.S., Form 990, Part IV (2013).

²⁴⁴ I.R.S., Form 990, Schedule H (2013).

²⁴⁵ See Fishman, *supra* note 20, at 581 (citing STAFF OF THE JOINT COMM. ON TAXATION, DESCRIPTION OF PRESENT LAW RELATING TO CHARITABLE AND OTHER EXEMPT ORGS. AND STATISTICAL INFO. REGARDING GROWTH AND OVERSIGHT OF THE TAX-EXEMPT SECTOR 38 tbl.5 (2004), available at <http://www.house.gov/jct/x-44-04.pdf>) (reporting that IRS is able to examine less than 2% of Form 990s filed); see also Elizabeth Schwinn & Grant Williams, *A Challenge for the IRS: Lack of Funds and Manpower Taxes Agency's Ability to Regulate Charities*, CHRON. OF PHILANTHROPY (Aug. 23, 2001), <http://philanthropy.com/article/A-Challenge-for-the-IRS/54046/>.

about the organization's operations, rather than just relying on the organization's projections in its Form 1023. It also ensures that every organization at some point is called to account for how it satisfies the doctrine. This is actually a familiar concept in the economic development arena; government agencies usually demand evidence of measurable results when they provide job creation assistance to for-profit businesses, and often claw back these benefits when a business does not carry through on its projections.²⁴⁶ As for charities, recently Congress, as part of the Patient Protection and Affordable Care Act, required that the IRS review the tax exempt status of each 501(c)(3) hospital every three years to ensure that it is providing an appropriate level of charitable care.²⁴⁷ This review, the details of which are still being worked out by the IRS, will amount to less than a full re-examination of the organization and may focus primarily on the disclosures the organization has made in its annual Schedule H to Form 990.²⁴⁸

C. *Considerations*

The strategies described above vary in terms of who bears responsibility for carrying them out, the "cost" of implementation, and the breadth of the standards, to name a few. It is also critical to bear in mind the "harm" we are attempting to resolve—the misuse of the charitable subsidy caused by imprecision in determining when economic development is charitable. Selecting and crafting one or more strategies into an effective solution necessitates prioritizing among these various considerations (some of which, when considered alone, could lead to significantly different solutions). In light of the concerns raised in this article, the following considerations are the most important:

²⁴⁶ See Lerch, *supra* note 205 at 1-9. (discussing states' passage of legislation intended to provide greater accountability).

²⁴⁷ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 9007(a), 124 Stat. 119, 855 (2010) (codified as amended at I.R.C. § 501(r) (2010)).

²⁴⁸ Kurt Bennion, *New Details on IRS Reviews of the Community Benefit Activities of 501(c)(3) Hospitals*, Clifton Larson Allen (Oct. 29, 2012), available at <http://www.cliftonlarsonallen.com/Health-Care/New-Details-on-IRS-Review-of-the-Community-Benefit-Activities-of-501c3-Hospitals.aspx> (last visited Apr. 23, 2013) (reporting on revelation by IRS official in October 2012 that IRS will conduct "stealth" reviews of one-third of hospitals every year based initially solely on their Form 990s and other public records without notifying the hospitals when the reviews take place).

1. Accuracy

One of this article's central contentions is that the jurisprudential standards the IRS employs in determining when economic development is charitable are too outdated and imprecise. They provide no established analytic structure for evaluating economic development organizations, allowing IRS agents to take a largely intuitive and discretionary approach to applying the private benefit doctrine. This, in turn, has led to outcomes that fail to meaningfully reflect the types of activities Section 501(c)(3) should allow and prohibit. For a category of organizations that provide aid to for-profit businesses with the objective that benefit eventually trickles down to a charitable class, the private benefit doctrine is not just a tangential subplot, but rather the lead story line in whether or not the organization is charitable. A sound solution should provide the ultimate decision-maker with enough information and the proper analytic tools to make good judgments about who is entitled to the charitable subsidy. The decision maker also needs to have the legal acumen and breadth of experience to accurately determine when the doctrine is satisfied.

2. Consistency

Closely aligned with, and yet distinct from, accuracy is consistency in decision-making to ensure that the private benefit doctrine is given equal weight among all economic development organizations seeking 501(c)(3) status. This is critical to increasing the precision of the IRS in evaluating these organizations. Furthermore, any perceived inconsistency will undoubtedly lead to organizations seeking the path of least resistance. For example, it is not difficult to imagine an organization adding government officials to its board of directors if organizations that lessen governmental burdens are subject to less scrutiny under the private benefit doctrine.

3. Flexibility

Recognizing that different economic development organizations provide different types of services (e.g. financing, technical assistance, incubator space) to different types of businesses (e.g. small retail stores, Biotech startups, growing manufacturers) in geographical areas of different sizes and facing different challenges, the ultimate solution needs to be flexible enough to allow for the accomplishment of charitable

economic development in a variety of circumstances. On the one hand, flexibility in standards might be viewed as conflicting with the preference for accuracy and consistency articulated in *considerations (1) and (2)* above. On the other, however, flexibility does not refer to how vigorously or consistently the standards would be applied, but rather to creating an approach that does not become so formulaic that it fails to accommodate the wide range of economic development practices one might fairly consider charitable. This consideration militates against strict numeric tests (for example, 80% of jobs created must be filled by low-income individuals) or narrowly drawn categories of permissible activities (for example, below-market loans to businesses owned exclusively by members of minority groups).

4. Accountability

Another central contention of this article is that there is no real mechanism to hold an organization accountable with respect to the private benefit doctrine after it has received recognition of its 501(c)(3) status. As explained throughout this article, the lack of ongoing accountability renders the doctrine fairly meaningless for economic development organizations. Any solution must address this problem. As with any accountability mechanism, the solution must be carefully crafted so that it elicits the right information and yet is not so onerous that it discourages organizations from pursuing valid charitable objectives or significantly detracts from their ability to accomplish them.

5. Sensitivity to Regulatory Resources

Although an annual review by the IRS of the activities of every one of the country's over one million 501(c)(3) organizations would no doubt increase the agency's precision in determining which organizations merit 501(c)(3) status, it would tax the resources of the IRS Exempt Organizations Division well beyond capacity.²⁴⁹ Any solution that requires

²⁴⁹ Fishman, *supra* note 20, at 581 (citing STAFF OF THE JOINT COMM. ON TAXATION, DESCRIPTION OF PRESENT LAW RELATING TO CHARITABLE AND OTHER EXEMPT ORGS. AND STATISTICAL INFO. REGARDING GROWTH AND OVERSIGHT OF THE TAX-EXEMPT SECTOR 38 table 5 (2004), available at <http://www.house.gov/jct/x-44-04.pdf>) (reporting that IRS is able to examine less than 2% of Form 990s filed); see also Elizabeth Schwinn & Grant Williams, *A Challenge for the IRS: Lack of Funds and Manpower Taxes Agency's Ability to Regulate Charities*, CHRON. OF PHILANTHROPY (Aug. 23, 2001), <http://philanthropy.com/article/A-Challenge-for-the-IRS/54046/>.

more agency involvement will result in some increase in administrative costs and the greater the scope of this involvement, the more unlikely the IRS will be able to bear it. Similarly, a solution that shifts the regulatory burden to others (like Boards) must take into account the challenges this would pose to the organizations at issue in identifying Board members with the time and expertise to play this role. So, accountability must be balanced with regulatory cost.

VI. THE SOLUTION

As argued throughout this article, the problem with the current approach to assessing place-based economic development as charitable is multi-faceted and, thus, so is the solution. It involves corresponding changes to both the current jurisprudence and to the practices the IRS utilizes in evaluating and monitoring economic development organizations with a primary objective of improving the agency's precision in determining which ones are charitable while staying mindful of the other considerations prioritized in Section V.

My recommended solution includes the following features:

- (a) the formal adoption by the IRS of more nuanced standards for evaluating charitable place-based economic development emphasizing more clearly the need for a strong nexus between the aid the organization provides to businesses and the direct alleviation of community economic distress;

and

- (b) an enhanced process that all place-based economic development organizations claiming 501(c)(3) status must adhere to so that the IRS is better equipped to apply the standards described in part (a) above both when the organization applies for 501(c)(3) status and on an ongoing basis. This process would include:
 - the submission by the organization of (i) a written community economic hardship assessment, identifying specific hardships related to the growth, attraction, or retention of businesses in the particular community the organization aims to serve, *and* (ii) a detailed action plan explaining with specificity how the

organization's activities will address the hardships identified in this assessment,

- which are reviewed by the IRS at the time of the organization's application for 501(c)(3) status and periodically thereafter, and
- which are reported on annually in the organization's Form 990 via a separate schedule.

This solution combines several of the possible strategies discussed in Part V(B), and it bears some resemblance to the new framework for the regulation of 501(c)(3) hospitals recently implemented by the Patient Protection and Affordable Care Act (the PPACA),²⁵⁰ with a heightened sensitivity to minimizing the additional regulatory burden on the IRS. A discussion of each of the critical features follows below.

A. *Updating the Standards*

As the primary arbiters of which organizations are recognized as charities, it is important that IRS agents have clear markers for making these determinations, especially when dealing with categories of organizations that present a regulatory challenge. Part III(A) of this article points to difficulties in applying all aspects of the IRS's 1970s era jurisprudential standards to modern day REDOs. While effectively modernizing these standards is easier said than done, good starting points would be for the IRS to (1) formally require that an economic development charity provide objective evidence that the entire area it plans to serve is suffering from economic distress, and (2) formally adopt a standard akin to the expanded analysis contained in its long cast-aside 1992 General Counsel Memorandum referenced in Part III(A).²⁵¹ This Memorandum provided that an economic development charity must show a strong nexus between the businesses it will aid and addressing the specific economic hardships encountered by the area it will serve.

As to the first suggestion, the goal is to provide IRS agents with some objective basis for distinguishing between

²⁵⁰ Patient Protection and Affordable Care Act, Pub. L. 111-148, 124 Stat. 119 (2010) (codified in scattered sections of the United States Code and Internal Revenue Code).

²⁵¹ I.R.S. Gen. Couns. Mem. 39,883 (Oct. 16, 1992).

areas of the country that are in need of some form of charitable economic aid from those that are not. In its current instructions to the application for recognition of 501(c)(3) status, the IRS hints that this may already be a part of its practice. The instructions suggest that an economic development organization that seeks to “combat community deterioration” should describe whether the area in which it plans to operate “ha[s] been declared blighted or economically depressed by a government finding” and, if it has not, consider whether an exemption under another subpart of Section 501(c) is more appropriate.²⁵² Expressly adopting, in a Revenue Ruling, a threshold like this as part of a test for qualifying as a charity makes good sense, as does broadening it to include similar findings by objective, third-party experts like qualified universities and research institutions. It establishes that, at a minimum, place-based charitable economic development must be directed at places suffering actual distress, and sets a baseline for what qualifies as adequate substantiation of this fact. Another alternative would be to tie the threshold more narrowly to a definition of economic distress in a particular statute or to a particular type of government finding. However, this may run the risk of too narrowly constraining the range of circumstances that constitute distress.

The second suggestion addresses a critical concern identified in Part IV(A) by requiring that an economic development organization like a REDO demonstrate that it has carefully tailored its assistance to for-profit enterprises to best meet the needs of the distressed in the area it serves. General Counsel Memorandum 39,883 contains the strongest IRS statement to date that a more liberal form of trickle down charity (essentially, aiding any businesses in a distressed area on the theory that increased economic activity in and of itself will produce some degree of public benefit) is not charity.²⁵³ This Memorandum also emphasized the need for two additional “nexus characteristics” in order to demonstrate eligibility for 501(c)(3) status: (1) the assistance provided to businesses must not be available from conventional sources because of the depressed nature of the area, and (2) the businesses aided must offer the “greatest community potential benefit” based on the problems experienced by that area.²⁵⁴

²⁵² I.R.S., Instructions for Form 1023, Part VIII, line 6a (2006).

²⁵³ I.R.S. Gen. Couns. Mem. 39,883 (Oct. 16, 1992).

²⁵⁴ *Id.*

Within these characteristics reside standards that are clearer for aspiring economic development charities to demonstrate satisfaction of, and for IRS agents to apply. First, the organization must show a shortage or inadequacy of whatever assistance it plans to provide to area businesses and that this shortfall is a result of location in an economically distressed area. One could conceive of an organization demonstrating this by comparing resources in the area it plans to serve to those of more economically prosperous areas. Second, the organization must demonstrate a strong link between the businesses it aids and the particular forms of distress suffered by the area it serves. General Counsel Memorandum 39,883 use of the phrase “greatest community benefit”²⁵⁵ indicates that an incidental or even a moderate link between the businesses aided and the problems faced by the community at issue is not enough; the nexus must be strong. The organization should be able to show that the success of the businesses it aids will have a clearly measurable and important impact on those suffering the effects of economic distress in the area it serves.

Up until this point, discussion of this change in standards has focused on economic development organizations that seek 501(c)(3) status on the basis of aiding distressed people and places. For organizations like these, there is fairly clear logic to imposing the more exacting standards discussed above.

But what about those REDOs that claim to lessen governmental burdens? These types of charities are also governed by the private benefit doctrine; but they can argue that they achieve considerable public benefit simply by reducing the cost of government to taxpayers.²⁵⁶ The charitable class of an organization like this conceivably includes all citizens, not just those that are distressed.

However, the private benefit doctrine does not assess public benefit alone. It assesses public benefit relative to private benefit.²⁵⁷ Economic development practices that provide assistance directly to private businesses yield substantial private benefit. As a result, if the quantitative component of the private benefit doctrine is to have any meaning, these

²⁵⁵ *Id.*

²⁵⁶ See Lars Gustafsson, “Lessening the Burdens of Government”: Formulating a Test for Uniformity and Rational Federal Income Tax Subsidies, 45 U. KAN. L. REV 787, 833 (1997) (suggesting that the application of the private benefit doctrine may be unnecessary for organizations able to demonstrate that they lessen governmental burdens as this demonstration itself should already suffice in satisfying the private benefit doctrine).

²⁵⁷ Treas. Reg. § 1.501(c)(3)–1(d)(1)(ii) (2008).

practices must yield public benefit so significant that, by comparison, the private benefit appears insubstantial.²⁵⁸ Reducing the cost of government, expanding the local tax base, and promoting business activity for the economic betterment of all those who reside in a community provide some measure of public benefit and, as a matter of law, usually provide sufficient justification to support the economic development acts of government, which are not subject to the private benefit doctrine.²⁵⁹ Nevertheless, the limited case law and IRS guidance available on this point indicate that the private benefit doctrine applicable to charities demands more.²⁶⁰

I propose that the more exacting standards I propose above for economic development organizations that aid the distressed should also apply to those that lessen the burdens of government. In other words, an organization that directly aids private businesses and seeks 501(c)(3) status for doing so should first have to demonstrate that the area it serves suffers from some form of distress that prevents it from attracting businesses and creating jobs, even if the organization's sole claim to charitable status is that it lessens governmental burdens. The rationale for requiring this is firmly rooted in the myriad theories underlying the existence of the charitable subsidy. These theories, as noted earlier, can be collectively understood as justifying the subsidy as necessary to incentivize the provision of meritorious and publicly beneficial goods and services that other segments of society are unwilling or unable to provide.²⁶¹ In economically healthy regions, one would expect that emerging and existing businesses with strong potential for growth attract capital, technical assistance, and other resources from banks, venture capital firms, and other private sector players on commercially reasonable terms. Private sector players in these regions are already sufficiently incentivized and able to determine which businesses are viable and to provide them with the

²⁵⁸ See I.R.S. Gen. Couns. Mem. 39,862.

²⁵⁹ See Anne C. Choe, *Blinson v. State and the Continued Erosion of the Public Purpose Doctrine in North Carolina*, 87 N.C. L. REV. 644 (2009) (discussing the "public purpose doctrine" that governs the economic development activities of government).

²⁶⁰ See *Quality Auditing Co. v. Comm'r*, 114 T.C. 498, 510 (2000) (private benefit doctrine provides an "exception" to rule that organizations that lessen governmental burden fulfill charitable purposes); see also I.R.S. Gen. Couns. Mem. 38,693 (Apr. 15, 1981) (casting doubt on whether organization that promotes local economic development would qualify under 501(c)(3) even if it in fact lessened governmental burdens due to amount of benefit businesses receive from organization's activities).

²⁶¹ See *supra* note 209.

necessary resources to launch. Thus, there is no need to subsidize charitable organizations to play this role.

Furthermore, using the charitable subsidy to incentivize the creation and attraction of jobs in already healthy economies may undermine other efforts to create and attract jobs in regions with distressed economies. Federal tax credits, exemptions, and other programs aimed at job creation and business formation are usually directed toward areas experiencing some level of economic distress.²⁶² Simultaneously utilizing the charitable subsidy, which is largely federally funded, to aid the efforts of state and local governments to increase commercial activity in areas with healthy economies seems contradictory.

A similar sentiment is often reflected in court cases and IRS materials addressing 501(c)(3) organizations that drift too far into territory where the private sector is functioning normally. In one of the few publicly available IRS rulings applying the private benefit doctrine to an organization claiming to lessen governmental burdens, the IRS opined, “because the activity engaged in by the subject organization is in a general area which is traditionally commercial (although the subject organization may very well be non-commercial), extreme caution should be exercised before an exempt status is awarded.”²⁶³ In a similar vein, the IRS stressed to its agents that they use “extreme caution” whenever asked by an economic development organization to approve its 501(c)(3) status using “a lessening the burdens rationale,” presumably out of a concern that it is difficult to justify activity that simply aims to promote commerce as charitable.²⁶⁴ As a general matter, courts and the IRS have interpreted Section 501(c)(3) to altogether exclude organizations that conduct activities substantially similar to those conducted by for-profit businesses or that operate with a distinctive “commercial hue” (this is known as the “commerciality doctrine”).²⁶⁵

Nonetheless, the IRS has not yet incorporated this sentiment into anything resembling a meaningful standard for economic development organizations that base their claim to charitable status on lessening the burdens of government. Requiring this type of an organization to show that the area it plans to serve is distressed is a good starting point for making

²⁶² See Simon, *supra* note 8, at 380.

²⁶³ I.R.S. Gen. Couns. Mem. 39,685 (Sept. 17, 1986).

²⁶⁴ Louthian & Friedlander, *supra* note 177, at 8.

²⁶⁵ See, e.g., *Airlie Found. v. I.R.S.*, 283 F. Supp. 2d 58 (D.D.C. 2003); *B.S.W. Group, Inc. v. Comm’r*, 70 T.C. 352 (1978).

a case that it satisfies the private benefit doctrine as it clearly links aid to private businesses with a substantiated public need. To make a full case the organization would have to show, like the organizations basing their claim on aiding the distressed, a strong nexus between the businesses it aids and improving economic distress.

B. Improving the Process

Holding economic development organizations to higher and more nuanced standards requires that those organizations provide the IRS with more and better information about their objectives and activities. Accordingly, my recommended solution requires that this type of an organization submit a (1) community economic hardship assessment and (2) action plan, which would be reviewed by the IRS upon application for 501(c)(3) status. Furthermore, the organization would annually report on the accomplishment of its action plan in its Form 990 and the IRS would periodically review these reports. More detail about each of the key aspects of this approach follows below:

1. Community Economic Hardship Assessment

This is a concept borrowed from the PPACA, which requires that a hospital prepare an assessment of the health needs of the community, which it serves every three years in order to be treated as a charitable 501(c)(3) organization.²⁶⁶ Economic development organizations seeking charitable status should likewise have to engage in an assessment of the conditions for business creation, cultivation, and retention in the communities they plan to serve. A critical distinction here is that the organization would have to identify more than just the “need” for jobs or companies within the community; every community wants and arguably needs more business activity and better jobs. The assessment would have to include a government finding or other objective third-party opinion (described in Part VI(A) above) that the area the organization will serve suffers from economic distress. The assessment would also have to describe the specific hardships that result from this distress—like unusually high unemployment or poverty rates, unusually low educational attainment statistics, significant numbers of blighted properties, or other hardships

²⁶⁶ I.R.C. §§ 501(r)(1)(A) and (3)(A)(i) (2010).

within the community intended to be served—as a foundation for justifying the types of businesses the organization will aid.

The community could be defined by geography or by demographically identifiable segments of a population experiencing a hardship. The community could occupy areas large or small; the focus during the organization's IRS review would be on the severity and pervasiveness of the hardship faced by the identified area rather than necessarily on the size of the area served. At the same time, however, as discussed below, the organization will need to show that the businesses it plans to aid will have a direct and measurable impact on alleviating the identified hardships.

2. Action Plan

Another concept borrowed from the new framework for regulating 501(c)(3) hospitals is that of an action plan closely linking the activities of the organization to the community hardships identified in the assessment.²⁶⁷ This is how the organization will demonstrate that it meets the “strong nexus” requirement. For example, if the hardship is that a community is experiencing high unemployment due to a poorly educated work force, the organization's action plan would need to show how the businesses it plans to aid would alleviate this particular type of unemployment.

The action plan would also need to include projections quantifying the value of the aid the organization plans to offer to businesses and the charitable economic impact of this aid. This type of information is commonly requested by government agencies that make grants, loans, tax abatements, and/or tax credits to for-profit businesses as a way of rationalizing the decisions the agencies make.²⁶⁸ It is reasonable to expect that 501(c)(3) economic development organizations would likewise provide some evidence of the charitable value generated by the tax subsidy they receive and pass along to for profit enterprises.

The requirements for the community economic hardship assessment and action plan are closely tied to satisfying the updated standards articulated in Part VI(A) and, by so doing, the private benefit doctrine. These requirements add critical content that the IRS can utilize to determine whether the qualitative and quantitative components of the doctrine are

²⁶⁷ I.R.C. § 501(r)(3)(A)(ii) (2010).

²⁶⁸ See, e.g., Lerch, *supra* note 205.

satisfied. The qualitative component requires that any private benefit be a “necessary concomitant” of the public benefit achieved.²⁶⁹ Requiring a clear identification of community hardships and an action plan that establishes a clear nexus to resolution of those hardships helps to satisfy this component. Requiring that an organization make a rough calculation of the private and public benefit its activities achieve provides a more substantive and consistent format for satisfying the quantitative component.²⁷⁰ At the same time, these requirements help to satisfy the preference for flexibility described in Part V(C)(3). The assessment and action plan would allow an organization to craft a unique portfolio of programming and intended outcomes to best match the economic hardships faced by the community it serves.

3. Subject to Initial and Subsequent Periodic IRS Reviews

A charitable economic development organization would submit its community economic hardship assessment and action plan when it applies for 501(c)(3) status. Recognition by the IRS of the organization’s 501(c)(3) status would essentially constitute an endorsement by the IRS that, if the organization conducts its activities consistent with these documents, it satisfies the private benefit doctrine. If the organization were to make any material change to either of these documents, it would need to submit the updated versions with its annual Form 990. In this way, economic development charities would be treated similarly to other 501(c)(3) organizations except in terms of the amount of information required.²⁷¹ In recognition, however, of the increased need for long-term accountability by charities engaged in economic development, the IRS would periodically re-examine the 501(c)(3) status of all economic development organizations on a rolling basis.

This feature, of course, raises a concern about IRS resources.²⁷² Relying instead on the boards of these organizations, the general public, and/or funders to monitor their activities, as several of the other strategies discussed in Part V do, are certainly cheaper alternatives for achieving some measure of long-term accountability. These alternative

²⁶⁹ See I.R.S. Gen. Couns. Mem. 39,862 (Nov. 21, 1991).

²⁷⁰ *Id.*

²⁷¹ I.R.S., Form 990, Part III, Line 2 (requiring that an organization report significant additions to its services).

²⁷² See *supra* note 245.

strategies raise other difficulties, however. It is unlikely that Board members or the general public possess the legal acumen necessary to accurately assess an organization's activities under the private benefit doctrine. Board members might be inclined to support an organization in any case as a matter of self-interest or to avoid undermining an organization in which they are heavily involved. Individual members of the general public cannot impose significant consequences on an organization that fails to satisfy the private benefit doctrine. While funders can cease providing financial support, this assumes that the funders are inclined to make this type of review and carry through on consequences, which, while plausible, is less certain and consistent than if the IRS plays a prominent role.

The recognition by an organization that it will have its 501(c)(3) status re-examined by the IRS at certain points in its lifespan creates a higher measure of accountability, but at a higher cost. To an extent, it is fair to expect the IRS to devote the level of resources necessary to carry out its responsibility as gate keeper of the charitable subsidy. At the same time, however, this cost can be contained to an extent by limiting the scope of the IRS review solely to the organization's compliance with the private benefit doctrine. Most, if not all, of the information necessary to conduct this review—that is, any updates to the community economic hardship assessment and action plan and yearly reports on the organization's accomplishment of the action plan (which enhanced 990 reporting will provide as described below)—would already be in the hands of the IRS. Finally, because the reviews would be done on a rolling basis rather than according to a fixed schedule, the IRS would have flexibility in terms of how often it conducts these reviews.

4. Reported on Form 990

The principal reporting mechanism to ensure an economic development organization's accountability under the private benefit doctrine would be a specialized schedule that the organization would need to complete each year and attach to its Form 990. The schedule would elicit specific information related to the organization's accomplishment of the objectives set forth in its action plan including, for example, the names and types of businesses the organization aided during the previous year, the forms of assistance it provided, criteria for determining eligibility for assistance, and statistics on the number and types of jobs created as a result of this assistance.

In addition to making it easier for the IRS to periodically review the organization, the schedule would provide some measure of accountability by the organization to the general public and funders. Furthermore, the process of having to review its operations each year with respect to the specific objectives set out in its community economic hardship assessment and action plan, and report on this to the IRS and the general public should serve to continually refocus the organization on the basis for its charitable status.

CONCLUSION

By its own terms, the private benefit doctrine defies precise application. Yet there are circumstances, ever increasingly as the intersection of the private and charitable sectors expand, where a primarily intuitive, one-time application of the doctrine falls short and risks serious misuse of our nation's charitable subsidy. Such is the case with "charitable" economic development where aid from charities to for-profit businesses must trickle down to charitable beneficiaries. At the same time that charitable economic development poses a special regulatory challenge for the IRS, it also plays a vital role in the revitalization of our nation's distressed regions that should not be discouraged by imposing overly burdensome regulation. The solution proposed in Part VI helps to more effectively assess when economic development is charitable in the way the law intends, and ensure that organizations that engage in it are accountable over their entire lifespan, without hindering their performance of charitable work.