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# Globalism, Public Policy, and Tax-Exempt Status: Are U.S. Charities Adrift at Sea

Nicholas A. Mirkay

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# GLOBALISM, PUBLIC POLICY, AND TAX-EXEMPT STATUS: ARE U.S. CHARITIES ADRIFT AT SEA?\*

NICHOLAS A. MIRKAY\*\*

*“Here is my first principle of Foreign Policy—good government at home.”<sup>1</sup>*

—William E. Gladstone,  
U.K. Prime Minister

*This Article wrestles with whether charitable organizations’ international activities can or should impact such organizations’ domestic tax exemption. It addresses the issues raised by such international activities—if those activities contravene current U.S. foreign policy or international law, is a charity’s tax-exempt status adversely affected? Does such contravention implicate the public policy doctrine? On one hand, this Article agrees with other legal scholars that the public policy doctrine needs congressional attention, including some codification of the doctrine to provide legislative boundaries and ensure against arbitrary and capricious application by the Internal Revenue Service (“IRS”). On the other hand, this Article contends that the automatic inclusion of U.S. foreign policy and international law as components of “established public policy” would be administratively impracticable and onerous and would result in significant compliance difficulties for charitable organizations. Considering all these challenges, this Article nevertheless proposes that some codification of the public policy doctrine accompanied by a listed transaction scheme, similar to those*

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1. GEORGE BROOKS, GLADSTONIAN LIBERALISM IN IDEA AND IN FACT 45 (London, Woodford Fawcett & Co., 1885).

*employed in other areas of the Internal Revenue Code (“Code”), could provide Congress and ultimately the IRS with the ability to target certain international activities as inherently in conflict with tax-exempt status. In addition, this Article proposes that the codification of the public policy doctrine should include an excise tax regime, as an alternative to revocation, to address isolated or small violations of the public policy doctrine in relation to a charitable organization’s overall tax-exempt activities. Although these proposals are not without pitfalls and criticisms, they will nevertheless provide practical guidance to charitable organizations, thereby aiding compliance and ensuring uniform treatment of charitable organizations with international activities or operations.*

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## INTRODUCTION

Globalism knows no strangers, and charitable organizations are no exception.<sup>2</sup> In 2010, domestic religious organizations alone gave

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2. This Article uses the terms “charitable organization,” “tax-exempt organization,” “exempt organization,” and “charities” to refer to nonprofit organizations that qualify for,

\$7.2 billion to developing countries, including support for disaster relief, housing, food and clothing, schools, and development projects.<sup>3</sup> Domestic operating foundations provided \$4.6 billion in aid to developing countries.<sup>4</sup> These astounding figures reflect the reality that domestic charitable organizations are increasingly global in their reach. Ostensibly, in most instances, financial and other support provided by domestic charities likely comports with, and furthers, those charities' tax-exempt purposes and missions. And, current federal income tax law does not explicitly prohibit charitable organizations from channeling donated funds in support of international organizations or even activities that violate current U.S. foreign policy or international law, unless that international organization constitutes a terrorist organization.<sup>5</sup> But, what if a domestic charity's international activities, including financial support, do not further its tax-exempt purpose? Specifically, what if a domestic charity channels its funds to support a foreign organization or activity that violates current U.S. foreign policy?

Commentators have recently raised this issue in the context of contributions to the development of Jewish settlements in the West Bank and East Jerusalem.<sup>6</sup> Although settlements in the West Bank

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and have been granted, an exemption from federal income tax. See I.R.C. § 501(c)(3) (2006). In addition, the terms "exemption" and "tax-exempt status" refer exclusively to federal income tax law and do not imply exemption under other federal tax laws, or under state or local laws, unless otherwise indicated. See Nicholas A. Mirkay, *Is It "Charitable" to Discriminate? The Necessary Transformation of Section 501(c)(3) into the Gold Standard for Charities*, 2007 WIS. L. REV. 45, 56-60 for a discussion of the meaning of "charitable" under § 501(c)(3) of the Code and the common practice of collectively referring to the entities listed in the statute (e.g., religious, educational, scientific, etc.) as "charitable."

3. HUDSON INST., INDEX OF GLOBAL PHILANTHROPY AND REMITTANCES 2012, at 8, 12 (2012), <http://www.hudson.org/files/publications/2012IndexofGlobalPhilanthropyandRemittances.pdf>.

4. *Id.* at 8, 11.

5. See § 501(p) ("suspend[ing] by operation of law" an organization's tax-exempt status if the organization has engaged in, or supported, a terrorist organization as defined in § 501(p)(2)). Federal income tax law also disallows any deductions for contributions to such suspended organizations. See *id.* § 501(p)(4). But see *id.* §§ 4942, 4945 (2006 & Supp. I 2007); Rev. Proc. 92-94, 1992-2 C.B. 507 (governing qualifying distributions by private foundations to foreign organizations, none of which specifically address the result if such distributions potentially violate U.S. foreign policy or international law). This Article does not purport nor conclude that any of the organizations or examples discussed in its introduction implicate § 501(p). Similarly, this Article will not specifically address the support of possible terrorist organizations or activities.

6. See, e.g., Jim Rutenberg et al., *Tax-Exempt Funds Aiding Settlements in West Bank*, N.Y. TIMES, July 6, 2010, at A1; Josh Nathan-Kazis, *Can Tax-Free Donations Fund Settlements?*, FORWARD.COM (Jan. 6, 2010), <http://www.forward.com/articles/122779/>.

have been intermittently suspended,<sup>7</sup> the Israeli government and certain “religious nationalist organizations” continued development in East Jerusalem, which appears to be contrary to current U.S. foreign policy under the Obama administration.<sup>8</sup> In the decade ending in 2010, over \$200 million in tax-deductible contributions were made to domestic charitable organizations that in turn support Jewish settlements in the West Bank and East Jerusalem.<sup>9</sup> The donations primarily fund schools, synagogues, and community centers, which likely further the domestic charities’ tax-exempt purposes.<sup>10</sup> Nonetheless, these donations contravene the U.S. policy of prohibiting financial aid from the U.S. government to fund these Israeli settlements.<sup>11</sup> Furthermore, these tax-deductible donations arguably infringe on the United States’s two-state solution to the Israeli-Palestinian conflict.<sup>12</sup> Finally, the continued support and development of West Bank settlements violates the established, decade-old official policy of the State of Israel.<sup>13</sup>

Charitable organizations’ involvement in these international activities has not escaped the notice of the IRS, which announced recently that it will pursue charities that “launder tax-exempt U.S. donations into illegal Israeli West Bank settlement activities.”<sup>14</sup> The IRS has further announced that it is preparing guidance that will address charities and international activities, but the guidance to date

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7. Rutenberg et al., *supra* note 6. *But see Obama Administration Drops Demand for Israeli Settlement Freeze*, FOXNEWS.COM (Dec. 7, 2010), <http://www.foxnews.com/politics/2010/12/07/officials-drops-demand-settlement-freeze/>.

8. Nathan-Kazis, *supra* note 6.

9. *See* Rutenberg et al., *supra* note 6.

10. *See id.*

11. *See* Amanda Berman, *Isn't It Ironic? The Undermining of American Public Policy by American Tax Law, and the Ramifications on Middle East Peace*, 10 CARDOZO PUB. L. POL'Y & ETHICS J. 81, 109–10 (2011) (“In a May 2011 speech at the State Department . . . President [Obama] said that the United States believes that negotiations should result in two states, with permanent . . . borders . . . based on the 1967 lines . . .” (citations omitted)); Margaret A. Weirich, *Hijacking the Charitable System: An Examination of Tax-Exempt Status for Charities that Support Israeli Settlements*, 14 J. GENDER RACE & JUST. 327, 353 (2010); Rutenberg et al., *supra* note 6.

12. *See* Berman, *supra* note 11, at 109–10 (noting that President Obama announced that the borders before the 1967 Arab-Israeli War, with some adjustments that account for Israeli West Bank settlements, should serve as the foundation for a peace agreement between the two countries).

13. *See id.* at 115 (“Israel’s consistent public policy since the Labor Party took control of the Knesset (Israeli legislature) in 1995 denies funding for outposts and contributions to groups devoted exclusively to settlement-building, and staunchly opposes any new construction in disputed West Bank territory.”).

14. *IRS Commissioner Says Service Will Pursue Charities Laundering Money to Aid West Bank*, DAILY TAX REP. (BNA) No. 12, at G-8 (Jan. 1, 2010).

appears to focus more on large exempt organizations with overseas operations and foreign bank accounts.<sup>15</sup> With both of these announcements as a backdrop, in late August 2010, a pro-Israel, nonprofit educational organization went public about its struggle with the IRS to obtain tax-exempt status under § 501(c)(3).<sup>16</sup> The organization, Z Street, filed a complaint in federal district court in Pennsylvania alleging that the IRS has adopted a procedure that specifically targets organizations with policies regarding Israel that oppose those of the Obama administration.<sup>17</sup> More specifically, the lawsuit alleged that a named IRS agent informed Z Street's counsel of two concerns regarding the organization's application for exemption: "(1) the advocacy activities in general, and (2) the IRS's special concern about applications from organizations whose activities are related to Israel, and that are organizations whose positions contradict the US Administration's Israeli policy."<sup>18</sup>

The IRS agent further informed the organization's counsel that applications of such Israel-related organizations have been assigned to "a special unit in the D.C. office to determine whether the organization's activities contradict the Administration's public policies."<sup>19</sup> Z Street sought both (1) a declaration that the IRS's current "policy" with respect to Israel-related organizations violates the organization's First Amendment free speech rights; and (2) injunctive relief barring the IRS from applying a "special policy" with

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15. IRS, IRS TAX EXEMPT & GOV'T ENTITIES, EXEMPT ORGANIZATIONS 2011 ANNUAL REPORT & 2012 WORKPLAN 9 (2011), [http://www.irs.gov/pub/irs-tege/fy2012\\_eo\\_work\\_plan\\_2011\\_annrpt.pdf](http://www.irs.gov/pub/irs-tege/fy2012_eo_work_plan_2011_annrpt.pdf); see also Fred Stokeld, *IRS Addressing Issues Involving EOs' International Activities*, *Official Says*, 65 EXEMPT ORG. TAX REV. 218 (Mar. 2010) (quoting an IRS official as saying that the IRS is "working on a publication that will address nonprofits and international activities").

16. See Complaint at 1, *Z Street v. IRS Comm'r*, No. 2:10-cv-04307-CMR (E.D. Pa., Aug. 25, 2010), 2010 U.S. Dist. Ct. Pleadings LEXIS 3230, at \*1, available at [http://www.zstreet.org/index.php?option=com\\_content&view=article&id=96:z-street-v-irs-commissioner&catid=5:must-read&Itemid=30](http://www.zstreet.org/index.php?option=com_content&view=article&id=96:z-street-v-irs-commissioner&catid=5:must-read&Itemid=30). All "section" references are to the Internal Revenue Code of 1986, as amended, unless otherwise indicated.

17. See *id.*

18. *Id.* at 5, 2010 U.S. Dist. Ct. Pleadings LEXIS 3230, at \*9.

19. *Id.* at 1, 2010 U.S. Dist. Ct. Pleadings LEXIS 3230, at \*1. In an affidavit, Jon Waddell, manager of the IRS's Exempt Organizations Determinations Group, denied that Z Street's application was referred to his "Touch and Go" or "TAG" group because of an "Israel Special Policy" or because Z Street's viewpoints on Israel contradicted those espoused by the Obama administration. Affidavit of Jon Waddell at 1, 6-7, *Z Street v. IRS Comm'r*, No. 2:10-cv-04307-CMR (E.D. Pa. Dec. 9, 2010), available at [http://www.zstreet.org/index.php?option=com\\_content&view=article&id=251%3Aaffidavit-of-irs-official-in-charge-of-qtagg-group&catid=1&Itemid=42](http://www.zstreet.org/index.php?option=com_content&view=article&id=251%3Aaffidavit-of-irs-official-in-charge-of-qtagg-group&catid=1&Itemid=42).

respect to its application for tax-exempt status and directing the IRS to disclose fully such policy.<sup>20</sup>

In a February 13, 2012, order, the United States District Court for the Eastern District of Pennsylvania found that Z Street's controversy was "best construed" as one arising out of § 7428, which provides declaratory judgment relief with respect to IRS inaction or an adverse determination pertaining to § 501(c)(3) applicants.<sup>21</sup> The court ordered that the case be transferred to the District Court for the District of Columbia.<sup>22</sup> In a footnote, the issuing judge stated, "The Court shares Plaintiff's view that this is a case about constitutionally valid process," responding to Z Street's contention that the "substance and application of the Israel Special Policy . . . constitutes discrimination among viewpoints and a violation of the Plaintiff's right to freedom of speech" under the First Amendment.<sup>23</sup> Although Z Street has argued that the true essence of its case—constitutionally protected speech and viewpoints—has eluded tax "experts,"<sup>24</sup> those experts have actually probed for answers to questions that could be very impactful in the long-term development of tax-exemption law: *Why* did the IRS delay on Z Street's application? What is the *underlying reason or reasons* for the Agency's purported "Israel Special Policy" and review unit? Is there a public policy issue lurking behind the IRS's actions?<sup>25</sup> Until the District Court for the District of

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20. Complaint, *supra* note 16, at 1–2, 2010 U.S. Dist. Ct. Pleadings LEXIS 3230, at \*1–2. The government filed a motion to dismiss Z Street's complaint. Memorandum in Support of United States' Motion to Dismiss, *Z Street v. IRS Comm'r*, No. 2:10-cv-04307-CMR (E.D. Pa. Nov. 1, 2010), *available at* [http://www.zstreet.org/index.php?option=com\\_content&view=article&id=138&Itemid=41](http://www.zstreet.org/index.php?option=com_content&view=article&id=138&Itemid=41). Z Street filed a memorandum in opposition to the government's motion to dismiss. Plaintiff's Memorandum in Support of United States' Motion to Dismiss, *Z Street v. IRS Comm'r*, No. 2:10-cv-04307-CMR (E.D. Pa. Nov. 22, 2010), *available at* [http://www.zstreet.org/index.php?option=com\\_content&view=article&id=216:z-sts-opposition-to-governments-motion-to-dismiss-the-complaint&catid=1](http://www.zstreet.org/index.php?option=com_content&view=article&id=216:z-sts-opposition-to-governments-motion-to-dismiss-the-complaint&catid=1).

21. *Z Street v. IRS Comm'r*, No. 2:10-cv-04307-CMR (E.D. Pa. Feb. 13, 2012), *available at* [http://www.zstreet.org/index.php?option=com\\_content&view=article&id=591:federal-court-recognizes-z-street-has-raised-constitutional-claim-against-irs&catid=5&Itemid=30](http://www.zstreet.org/index.php?option=com_content&view=article&id=591:federal-court-recognizes-z-street-has-raised-constitutional-claim-against-irs&catid=5&Itemid=30).

22. *Id.*

23. *Id.* at n.1.

24. See *Major Development in Z ST v. IRS case*, Z STREET, [http://www.zstreet.org/index.php?option=com\\_content&view=article&id=140&Itemid=39](http://www.zstreet.org/index.php?option=com_content&view=article&id=140&Itemid=39) (last visited Nov. 13, 2012) ("And [the case] is not, as the IRS claimed and several tax "experts" have opined, a claim merely seeking a tax exemption or complaining that the IRS has taken too long to make a decision.").

25. "Public policy issue" refers to the public policy doctrine as enunciated by the United States Supreme Court in *Bob Jones University v. United States*, 461 U.S. 574, 595 (1983). See *infra* notes 62–83 and accompanying text for further discussion.

Columbia rules on the merits of the organization's complaint, legal commentators can only speculate. In the interim, Z Street's exemption dispute raises the specter that the IRS views U.S. foreign policy as impactful on a domestic organization's tax-exempt status—a potentially significant development that may have far-reaching consequences for domestic tax-exempt organizations participating in international activities.

That specter has fueled certain activist groups to solicit IRS involvement with respect to domestic charities that violate U.S. foreign policy or engage in activities abroad that would be legally problematic in the United States.<sup>26</sup> One such group, Stop the JNF Campaign, is demanding that the IRS revoke the exemption of the Jewish National Fund (“JNF”) because the JNF allegedly “funds activities in Israel and the Occupied West Bank that are both contrary to the public policy of the United States and inconsistent with activities of a charitable or environmental organization.”<sup>27</sup> The Campaign further alleges that the JNF has “discriminatory land-use restrictions” that bar native Palestinians from leasing or otherwise inhabiting JNF land in Israel.<sup>28</sup> Examples of potentially problematic

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26. The IRS's 2012 work plan included guidance on the international activities of domestic charitable organizations, but the focus is primarily on “whether assets of exempt organizations that are dedicated for charitable purposes internationally are being diverted for non-charitable purposes . . . .” Diane Freda, *Political, International Activity Get New Focus Under IRS's Exempt Organization Work Plan*, DAILY TAX REP. (BNA) No. 26, at G-7 (Feb. 9, 2012). The IRS is most concerned with whether the international operations of domestic charitable organizations are consistent with such organizations' charitable purposes. See *id.* The 2013 work plan similarly focuses on excessive private benefit and insufficient charitable activity in the context of foreign grants and activities. See IRS, IRS TAX EXEMPT & GOV'T ENTITIES, EXEMPT ORGANIZATIONS 2012 ANNUAL REPORT & 2013 WORKPLAN 19 (2012), [http://www.irs.gov/pub/irs-tege/FY2012\\_EO\\_AnnualRpt\\_2013\\_Work\\_Plan.pdf](http://www.irs.gov/pub/irs-tege/FY2012_EO_AnnualRpt_2013_Work_Plan.pdf).

27. STOP THE JNF CAMPAIGN, [http://www.stopthejnf.org/unitedstates\\_takeaction\\_irsletter.html](http://www.stopthejnf.org/unitedstates_takeaction_irsletter.html) (last visited Nov. 13, 2012); see also Josh Nathan-Kazis, *JNF Challenged on Discrimination*, FORWARD.COM (Apr. 20, 2011), <http://www.forward.com/articles/137187/> (noting that the Campaign also refers to JNF's policies prohibiting the sale of land to Palestinians as “discriminatory”).

28. STOP THE JNF CAMPAIGN, *supra* note 27. In March 2011, the State Department released its “2009 Human Rights Report: Israel and the Occupied Territories.” U.S. DEPT. OF STATE, 2009 HUMAN RIGHTS REPORT: ISRAEL AND THE OCCUPIED TERRITORIES (2009), available at <http://www.state.gov/g/drl/rls/hrrpt/2009/nea/136070.htm> (“Approximately 93 percent of land [in Israel] was in the public domain, and the Jewish National Fund (JNF), whose statutes prohibit sale or lease of land to non-Jews, owned approximately 12.5 percent. In 2005 the attorney general ruled the [Israeli] government cannot discriminate against Arab citizens of Israel in marketing and allocating lands it manages, including those of the JNF. As an interim measure, the government agreed through the Israel Lands Administration (ILA) to compensate the JNF for any land leased to an Arab by transferring an equal amount of land from the ILA to the JNF.”).



international activities are not just limited to U.S. foreign policy with respect to Israel. Purportedly, American charities supported the Irish Republican Army's armed conflict with the British government in contravention of U.S. foreign policy at the time.<sup>29</sup> In addition, any charity that funds or otherwise supports activities abroad could find that such funding or support violates U.S. foreign policy, public policy, or law, including international law,<sup>30</sup> such as exploitation of child labor, racial discrimination in education, or denial of voting rights to women. All of these examples raise the issue introduced above: whether a domestic charity's international activities can or should impact its charitable exemption under U.S. law.

As previously stated, current federal income tax law does not explicitly prohibit charitable organizations from channeling donated funds in support of international organizations or activities that violate current U.S. foreign policy or international law.<sup>31</sup> The IRS has recently stated: "Proper control and discretion over use of funds is required when U.S. charities are making grants to foreign charities . . . . U.S. charities operating abroad must adhere to the same . . . 501(c)(3) rules as charities operating in the United States . . . ."<sup>32</sup> However, in making that comment, the IRS only referenced the private benefit, private inurement, lobbying, and political campaign activity rules,<sup>33</sup> none of which are necessarily implicated in the situations presented herein.<sup>34</sup> Accordingly, the only possible restraint on this type of international support exists in the public policy doctrine enunciated by the United States Supreme Court in *Bob Jones University v. United States*,<sup>35</sup> which granted the Treasury Department (and the IRS by delegation) the power to revoke the tax-exempt status of an organization whose purpose violates "established public policy."<sup>36</sup>

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29. See Kevin Cullen, *America and the Conflict*, PBS.ORG, <http://www.pbs.org/wgbh/pages/frontline/shows/ira/reports/america.html> (last visited Nov. 13, 2012).

30. See *infra* notes 143–60 and accompanying text for additional discussion on how international law can be considered U.S. domestic law, thereby potentially impacting a charitable organization's tax-exempt status.

31. See *supra* note 5 and accompanying text.

32. Diane Freda, *Control Is Needed over Use of Funds in Foreign Granting-Making Arena*, IRS Says, DAILY TAX REP. (BNA) No. 151, at G-5 (Aug. 5, 2012).

33. See *infra* notes 43, 55–59, and accompanying text for additional discussion of these rules.

34. As discussed above, the IRS has yet to direct specific attention to the issues discussed in this Article. See *supra* note 26.

35. 461 U.S. 574 (1983).

36. *Id.* at 586; see also Mirkay, *supra* note 2, at 51 (discussing *Bob Jones*).

The IRS, however, has only used the doctrine to revoke tax-exempt status in instances where the organizations participated in racial discrimination in education, advocated civil disobedience, or were involved in an illegal activity.<sup>37</sup> Despite its merits, the doctrine's main failure is its lack of a clearly defined source of "established public policy." And, the doctrine becomes even more complicated when U.S. foreign policy is potentially included under the scope of "established public policy."<sup>38</sup> Additionally, legal scholars have routinely raised another concern—whether the public policy doctrine places too much discretion in the IRS, a regulatory agency.<sup>39</sup>

Accordingly, this Article wrestles with whether charitable organizations' international activities can or should impact such organizations' domestic tax exemption. Should a domestic charity's financial support of international activities that violate current U.S. foreign policy adversely affect that charity's tax-exempt status? How does a domestic charity comply with the myriad of international laws that may be implicated by their activities abroad? Does the contravention of U.S. foreign policy or international law implicate the public policy doctrine enunciated in *Bob Jones University*? On one hand, this Article agrees with other legal scholars that the public policy doctrine needs congressional attention, including some codification of the doctrine to provide legislative boundaries and ensure against arbitrary and capricious application by the IRS.<sup>40</sup> On the other hand, this Article contends that the automatic inclusion of U.S. foreign policy and international law as components of "established public policy" would be administratively impracticable and onerous and would result in significant compliance difficulties for charitable organizations. Particularly, U.S. foreign policy should not be deemed "established public policy" because foreign policy

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37. See Mirkay, *supra* note 2, at 51; see also David A. Brennen, *The Power of the Treasury: Racial Discrimination, Public Policy and "Charity" in Contemporary Society*, 33 U.C. DAVIS L. REV. 389, 391 n.2 (2000) ("We believe that engaging in conduct or arrangements that violate the anti-kickback statute is inconsistent with continued exemption as a charitable hospital.").

38. Mirkay, *supra* note 2, at 51, 67; see also Brennen, *supra* note 37, at 403–04, 407, 436–39 (raising the fundamental issue of which sources of law or current policy the IRS should consult to determine that a national public policy exists).

39. See, e.g., David A. Brennen, *Tax Expenditures, Social Justice, and Civil Rights: Expanding the Scope of Civil Rights Laws to Apply to Tax-Exempt Charities*, 2001 BYU L. REV. 167, 186–87; Brennen, *supra* note 37, at 411–28, 446; Johnny Rex Buckles, *Reforming the Public Policy Doctrine*, 53 U. KAN. L. REV. 397, 407–08 (2005); Charles O. Galvin & Neal Devins, *A Tax Policy Analysis of Bob Jones University v. United States*, 36 VAND. L. REV. 1353, 1372–73 (1983).

40. See, e.g., Buckles, *supra* note 39, at 468–77.

routinely lacks clarity and definition—a central tenet of foreign policy is the deference given to the President, a post that may change every four years. Similarly, the mere difficulty in defining what constitutes international law reveals the initial complication in integrating this area of law into domestic tax exemption law.

Part I of this Article provides a statutory and regulatory framework, including a discussion of the public policy doctrine. It scrutinizes the failure of the existing framework and the public policy doctrine to address potential conflicts between charitable organizations' international activities and U.S. foreign policy or international law. Part II further examines the definitional and compliance challenges associated with mandating that U.S. foreign policy and international law constitute "established public policy" for purposes of the doctrine. Considering all these definitional challenges, this Article nevertheless proposes in Part III that some codification of the public policy doctrine accompanied by a listed transaction scheme, similar to those employed in other areas of the Code,<sup>41</sup> could provide Congress and ultimately the IRS with the ability to target certain international activities as inherently in conflict with tax-exempt status. In addition, this Article proposes that the codification of the public policy doctrine should include an excise tax regime to address isolated or small violations of the public policy doctrine in relation to a charitable organization's overall tax-exempt activities. Particularly, such an excise tax regime would serve as an alternative to revocation in such instances. Although these proposals are not without pitfalls and criticisms, they will nevertheless provide practical guidance to charitable organizations, thereby aiding compliance and ensuring uniform treatment of charitable organizations with international activities or operations.

## I. THE PUBLIC POLICY IMPACT ON CHARITABLE EXEMPTION

### A. *Overview of the Federal Income Tax Exemption*<sup>42</sup>

In order to discuss the potential limitations on, and effect of, charitable organizations engaging in international activities, a brief overview of the exemption statute and the regulatory tests that must be satisfied before the IRS grants an exemption is necessary.

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41. See *infra* notes 170–71 and accompanying text.

42. Portions of the discussion in this subpart are substantially similar to a corresponding portion contained in Mirkey, *supra* note 2, at 54–56.

Section 501(c)(3) provides for the federal income-tax exemption of nonprofit corporations and certain other entities

organized and operated exclusively for religious, charitable, scientific . . . or educational purposes . . . no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation . . . and which does not participate in, or intervene in . . . any political campaign on behalf of (or in opposition to) any candidate for public office.<sup>43</sup>

IRS regulations and rulings define the meaning of each of the eight specific exempt purposes listed in the statute (for example, religious, charitable,<sup>44</sup> and educational).<sup>45</sup> Section 501(c)(3) establishes both an organizational test and an operational test for determining whether an organization fulfills its exempt purposes;<sup>46</sup> to qualify for exemption, an organization must meet both tests.<sup>47</sup> The organizational test relates solely to the language used in the organization's governing documents.<sup>48</sup> An organization meets the requirements of the test if it was organized exclusively for at least one tax-exempt, charitable purpose.<sup>49</sup> This is possible only if the organizing document (1) limits the organization's purpose to one or more exempt purposes, and (2) does not expressly empower it to substantially engage in activities that do not further any exempt

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43. I.R.C. § 501(c)(3) (2006). Specifically, § 501(a) provides that "[a]n organization described in subsection (c) or (d) . . . shall be exempt from taxation under this subtitle." *Id.* § 501(a).

44. See Mirkay, *supra* note 2, at 56–60 and *infra* note 80 and accompanying text for a discussion of the meaning of "charitable" under § 501(c)(3) and the common practice of collectively referring to the entities listed in the statute as "charitable." In addition, the IRS has determined that other qualifying purposes meet the overall public-benefit principle of § 501(c)(3) based on an expansive interpretation of "charitable." See Brennen, *supra* note 39, at 178.

45. See Treas. Reg. § 1.501(c)(3)-1(d) (as amended in 2008) (religious, charitable, scientific, testing for public safety, literary, educational, or prevention of cruelty to children or animals). § 501(c)(3) lists as an eighth exempt purpose "to foster national or international amateur sports competition," which is not addressed by any regulation. I.R.C. § 501(c)(3).

46. See I.R.C. § 501(c)(3).

47. See Treas. Reg. § 1.501(c)(3)-1(a)(1).

48. See *id.* § 1.501(c)(3)-1(b)(1)(i).

49. See *id.* § 1.501(c)(3)-1(a)(1).

purposes.<sup>50</sup> The organizational test also imposes requirements on the distribution of the organization's assets upon dissolution.<sup>51</sup>

The issues that this Article focuses on most likely implicate the operational test. The purpose of the operational test is to ensure that an exempt organization's resources and activities are devoted primarily to its exempt purposes. The regulations break down the operational test into two components: (1) the primary-purpose-or-activity test and (2) the private-inurement prohibition.<sup>52</sup> Under the primary-purpose-or-activity test, "[a]n organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3)."<sup>53</sup> An organization will not pass this test if "more than an insubstantial part of its activities is not in furtherance of an exempt purpose."<sup>54</sup>

Under the private-inurement prohibition, an organization will not satisfy the operational test "if its net earnings inure in whole or in part to the benefit of private shareholders or individuals."<sup>55</sup> The regulations define the term "private shareholder or individual" as "persons having a personal and private interest in the activities of the organization"<sup>56</sup> such as officers, directors, or other individuals in a position to assert influence or control over the organization's operations and activities.<sup>57</sup> The prohibition is absolute—any amount of inurement is impermissible.<sup>58</sup> Organizations exempt under § 501(c)(3) are also subject to other limitations with respect to their operations, including the private-benefit doctrine.<sup>59</sup>

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50. *See id.* § 1.501(c)(3)-1(b)(1)(i).

51. *See id.* § 1.501(c)(3)-1(b)(4). The IRS typically implements this regulation by requiring an organization, either in its governing document or under relevant state law, to explicitly dedicate its assets to one or more exempt purposes in the event of dissolution. *Id.*

52. *See id.* § 1.501(c)(3)-1(c)(1) to (2).

53. *Id.* § 1.501(c)(3)-1(c)(1).

54. *Id.*

55. *Id.* § 1.501(c)(3)-1(c)(2).

56. *Id.* § 1.501(a)-1(c) (as amended in 1982); *see also* I.R.S. Gen. Couns. Mem. 39,862, 1991 WL 776308, at \*7 (Nov. 22, 1991) ("The proscription against inurement generally applies to . . . persons who, because of their particular relationship with an organization, have an opportunity to control or influence its activities.").

57. *See* BRUCE R. HOPKINS, *THE LAW OF EXEMPT ORGANIZATIONS* § 20.3, at 510 (10th ed. 2011).

58. *See* Treas. Reg. § 1.501(c)(3)-1(c)(2).

59. *See id.* § 1.501(c)(3)-1(d)(1)(ii). For further discussion on the private-benefit doctrine and other operational restrictions, *see* Nicholas A. Mirkay, *Relinquish Control! Why the IRS Should Change Its Stance on Exempt Organizations in Ancillary Joint Ventures*, 6 NEV. L.J. 21, 30–34 (2005).

### B. *The Public Policy Doctrine*

As previously mentioned, the Court's decision in *Bob Jones University* imposes the additional, nonstatutory public policy doctrine on an organization seeking tax-exempt status under § 501(c)(3).<sup>60</sup> By failing to articulate a clearly defined source of "established public policy," courts have left the doctrine open to the IRS's unfettered discretion,<sup>61</sup> which may allow for the arbitrary or even discriminatory treatment of proposed entities on the ill-defined basis of "public policy."

#### 1. Overview—*Bob Jones University v. United States*<sup>62</sup>

The controversy that culminated in the Supreme Court's decision in *Bob Jones University* began in early 1970 when a federal district court issued a preliminary injunction compelling the IRS to deny tax exemption to Mississippi private schools with racially discriminatory admissions policies.<sup>63</sup> Until that time, the IRS granted tax-exempt status to private schools regardless of any racially discriminatory admissions policy.<sup>64</sup> In response to the injunction, the IRS discontinued granting exemptions in such instances and also began prohibiting deductions for charitable contributions to schools acting in a racially discriminatory manner.<sup>65</sup> The IRS notified private schools of this new policy by means of a press release and a letter.<sup>66</sup> In addition, it issued a revenue ruling formally establishing this new policy, requiring these schools to adopt and maintain a policy of nondiscrimination with respect to students in their admissions

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60. See *Bob Jones Univ. v. United States*, 461 U.S. 574, 585–86 (1983).

61. See Brennen, *supra* note 39, at 178 & n.48.

62. The discussion in this subpart is a modified version of the discussion contained in Mirkay, *supra* note 2, at 61–65.

63. See *Green v. Kennedy*, 309 F. Supp. 1127, 1140 (D.D.C. 1970); see also Galvin & Devins, *supra* note 39, at 1357 ("The *Green* court suggested that the IRS would not be permitted to grant tax-exempt status to institutions that violate the government's public policy of nondiscrimination."). One year later, the United States District Court for the District of Columbia permanently enjoined the IRS from granting tax-exempt status to any Mississippi school that failed to publicly sustain a nondiscrimination policy. See *Green v. Connally*, 330 F. Supp. 1150, 1179–80 (D.D.C. 1971), *aff'd mem. sub nom. Coit v. Green*, 404 U.S. 997 (1971).

64. See *Bob Jones Univ.*, 461 U.S. at 577.

65. See Rev. Rul. 71-447, 1971-2 C.B. 230; see also Brennen, *supra* note 37, at 400–01 ("In response to the preliminary injunction, the IRS issued a news release indicating that it could not 'legally justify' granting charitable status to private schools that racially discriminate, nor could it allow tax deductions for contributions to such schools.").

66. See *Bob Jones Univ.*, 461 U.S. at 578; Brennen, *supra* note 37, at 401.

processes, scholarship and loan programs, and school-administered programs (like athletics).<sup>67</sup>

Upon receiving formal notification from the IRS of the new nondiscrimination requirement for private schools, Bob Jones University first filed suit in 1971 in an attempt to enjoin the IRS from revoking its tax exemption.<sup>68</sup> On January 19, 1976, the IRS revoked the University's charitable exemption retroactive to the day after the date on which the University received the notification letter regarding the IRS's change in policy for private schools.<sup>69</sup> As a vehicle for challenging the revocation of its exemption, the University filed suit in federal district court seeking a refund of the federal unemployment tax it paid to the IRS for the year 1975.<sup>70</sup> The government counterclaimed for unpaid taxes.<sup>71</sup>

The district court determined that the revocation of the University's exempt status exceeded the IRS's delegated powers and violated the University's First Amendment religious rights.<sup>72</sup> The United States Court of Appeals for the Fourth Circuit reversed the district court decision on appeal, stating that an educational institution must be "charitable in the broad common law sense, and . . . therefore must not violate public policy" to be eligible for

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67. See Rev. Rul. 71-447, 1971-2 C.B. at 230-31. In explaining the basis for the ruling, the IRS stated the following:

Under common law, the term "charity" encompasses all three of the major categories identified separately under section 501(c)(3) of the Code as religious, educational, and charitable. Both the courts and the Internal Revenue Service have long recognized that the statutory requirement of being "organized and operated exclusively for religious, charitable, \*\*\* or educational purposes" was intended to express the basic common law concept. Thus, a school asserting a right to the benefits provided for in section 501(c)(3) of the Code as being organized and operated exclusively for educational purposes must be a common law charity in order to be exempt under that section.

*Id.* at 230. In concluding that a school without a racially nondiscriminatory policy with respect to students is not "charitable," the IRS relies on the charitable-trust principle that "the purpose of the trust may not be illegal or contrary to public policy." *Id.* The IRS subsequently released guidelines for determining whether a private school has adequately publicized its racially nondiscriminatory policy. See Rev. Proc. 75-50, 1975-2 C.B. 587, 587-90; Rev. Proc. 72-54, 1972-2 C.B. 834.

68. See *Bob Jones Univ.*, 461 U.S. at 581.

69. See *id.* at 581.

70. See *id.* at 581-82.

71. See *id.*

72. See *Bob Jones Univ. v. United States*, 468 F. Supp. 890, 906 (D.S.C. 1978), *rev'd*, 639 F.2d 147 (4th Cir. 1980), *aff'd*, 461 U.S. 574 (1983).

exemption.<sup>73</sup> Furthermore, the court of appeals determined that the University failed this requirement because its “racial policies violated the clearly defined public policy, rooted in our Constitution, condemning racial discrimination and, more specifically, the government policy against subsidizing racial discrimination in education, public or private.”<sup>74</sup>

The Supreme Court affirmed the Fourth Circuit’s decision by a vote of eight to one.<sup>75</sup> The Court noted that in order to qualify for exempt status under § 501(c)(3), an organization must (1) fall within one of eight categories set forth in the statute and (2) demonstrate that its activities are not contrary to “established public policy.”<sup>76</sup> In opting for a broader concept of charity, the Court rejected the University’s argument that the eight categories are disjunctive and, therefore, an organization need not also qualify as “charitable” to be tax-exempt.<sup>77</sup> The Court observed that although § 501(c)(3) does not explicitly impose a public-policy limitation, Congress nevertheless intended that “entitlement to tax exemption depends on meeting certain common law standards of charity—namely, that an institution . . . must serve a public purpose and not be contrary to established public policy.”<sup>78</sup>

The Court further observed the interaction between § 170 and § 501(c)(3), explaining that in enacting both sections, “Congress sought to provide tax benefits to charitable organizations, to encourage the development of private institutions that serve a useful public purpose or supplement or take the place of public institutions of the same kind.”<sup>79</sup> Accordingly, the *Bob Jones University* decision solidified the view that there is a “charitable” overlay to all exempt organizations described in § 501(c)(3), and thereby provided the means necessary to impose a public-policy limitation.<sup>80</sup>

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73. See *Bob Jones Univ. v. United States*, 639 F.2d 147, 151 (4th Cir. 1980) (citations omitted), *aff’d*, 461 U.S. 574 (1983); *Bob Jones Univ.*, 461 U.S. at 582.

74. *Bob Jones Univ.*, 639 F.2d at 151.

75. See *Bob Jones Univ.*, 461 U.S. at 576.

76. See *id.* at 585.

77. See *id.* at 585–86.

78. *Id.* at 586. In response to the University’s “plain language” argument that § 501(c)(3) was devoid of any “charitable” overlay to all of the purposes delineated therein, the Court stated, “It is a well-established canon of statutory construction that a court should go beyond the literal language of a statute if reliance on that language would defeat the plain purpose of the statute . . . .” *Id.*

79. *Id.* at 588.

80. Cf. Miriam Galston, *Public Policy Constraints on Charitable Organizations*, 3 VA. TAX REV. 291, 292 (1984) (“[T]he Supreme Court has misread the common law of charity into the Code while confusing the public policy and public benefit strands of charitable



To support its conclusion that Bob Jones University violated an "established public policy" and, thus, could not be considered charitable, the United States Supreme Court stated that "[a]n unbroken line of cases following *Brown v. Board of Education* establishes beyond doubt this Court's view that racial discrimination in education violates a most fundamental national public policy, as well as rights of individuals."<sup>81</sup> In addition to *Brown*, the Court relied on the Civil Rights Acts, as well as executive orders issued over a forty-year period, to conclude that eliminating racial discrimination in education was an established national public policy.<sup>82</sup> Ultimately, the Court relied on the aggregated pronouncements of all three branches of government as constituting "established public policy."<sup>83</sup>

In response to the University's argument that the public-policy doctrine violated its First Amendment free exercise rights, the Court affirmed that certain compelling governmental interests can justify regulating certain religiously based conduct.<sup>84</sup> In finding that the government's interest in eradicating racial discrimination in education was sufficiently compelling to overcome any First Amendment concerns, the Court concluded that the "[d]enial of tax benefits will inevitably have a substantial impact on the operation of private religious schools, but will not prevent those schools from observing their religious tenets."<sup>85</sup>

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trust law.")). As the lone dissenter in *Bob Jones University*, Justice Rehnquist rejected the notion that there existed a charitable overlay to each of the delineated purposes in § 501(c)(3). *Bob Jones Univ.*, 461 U.S. at 615 (Rehnquist, J., dissenting). He concluded that "the legislative history of § 501(c)(3) unmistakably makes clear that *Congress has decided* what organizations are serving a public purpose and providing a public benefit within the meaning of § 501(c)(3) and has clearly set forth in § 501(c)(3) the characteristics of such organizations." *Id.*; see also Galvin & Devins, *supra* note 39, at 1363 ("Justice Rehnquist . . . endorsed the University's argument that the legislative history militated against a finding that section 501(c)(3) required common law charity.").

81. *Bob Jones Univ.*, 461 U.S. at 593 (citing *Brown v. Board of Educ.*, 374 U.S. 483 (1954)).

82. See *id.* at 593-95; Brennan, *supra* note 37, at 403-04.

83. *Bob Jones Univ.*, 461 U.S. at 598.

84. See *id.* at 603. The Court relied, in part, on *Prince v. Massachusetts*, 321 U.S. 158 (1944), summarizing its holding that "neutrally cast child labor laws prohibiting sale of printed materials on public streets could be applied to prohibit children from dispensing religious literature." *Id.* at 603.

85. *Id.* at 603-04. The Court further concluded that the government's interest "substantially outweighs whatever burden denial of tax benefits places on petitioners' exercise of their religious beliefs. The interests asserted by petitioners cannot be accommodated with that compelling governmental interest . . . and no 'less restrictive means' . . . are available to achieve the governmental interest." *Id.* at 604 (citations omitted).

## 2. Criticism of the Public Policy Doctrine

Although the Court in *Bob Jones University* reached the correct result, it has nevertheless sparked extensive scholarly deliberation and criticism over the last thirty years. Critics have disparaged the Court for concluding that a charitable overlay to § 501(c)(3) exists and for imposing a public-policy limitation on the exemption statute.<sup>86</sup> They likewise have rebuked the Court for “abdicat[ing] its supervisory powers to the IRS” and “supplant[ing] the role of Congress as lawmaker by making broad tax policy pronouncements,” rather than exercising the necessary oversight to ensure that the IRS properly enforces the tax laws.<sup>87</sup>

Legal scholars have criticized the doctrine as lacking legal or statutory authority and a “clearly defined scope of applicability.”<sup>88</sup> Since the IRS’s adoption of its racial nondiscrimination policy in 1970, Congress has neither enacted any law that codifies the public policy doctrine<sup>89</sup> nor provided the IRS with statutory authority to solely determine public policy and act thereon.<sup>90</sup> As a consequence, some scholars have questioned whether the IRS is the appropriate federal agency to determine if a charitable organization violates an “established public policy.”<sup>91</sup> In his concurrence in *Bob Jones University*, Justice Powell appeared to agree. To support his assertion that this task belongs to Congress, Justice Powell quoted Justice Blackmun’s dissent in a prior Supreme Court decision:

[W]here the philanthropic organization is concerned, there appears to be little to circumscribe the almost unfettered power

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86. See, e.g., Galston, *supra* note 80, at 292 (“[T]he Supreme Court has misread the common law of charity into the Code while confusing the public policy and public benefit strands of charitable trust law.”); Galvin & Devins, *supra* note 39, at 1379–80 (“[T]he Court went too far in interposing into the Code its own standards of ‘common community conscience’ and ‘public purpose.’”).

87. Galvin & Devins, *supra* note 39, at 1379.

88. Brennen, *supra* note 39, at 186; see also Buckles, *supra* note 39, at 407 (“[T]he IRS (like the Court) has not disclosed its understanding (if any) of the precise contours of the doctrine.”).

89. See Brennen, *supra* note 39, at 186 & n.83.

90. See Brennen, *supra* note 37, at 446; Brennen, *supra* note 39, at 187; Galvin & Devins, *supra* note 39, at 1379. Congress did, however, enact § 501(i) of the Internal Revenue Code, which prohibits discrimination by certain social clubs. See I.R.C. § 501(i) (2006). Justice Rehnquist referred to the existence of § 501(i) in his *Bob Jones University* dissent as evidence that if Congress “wants to add a requirement prohibiting racial discrimination to one of the tax-benefit provisions, it is fully aware of how to do it.” *Bob Jones Univ.*, 461 U.S. at 621 (Rehnquist, J., dissenting).

91. See Brennen, *supra* note 37, at 426–27; Buckles, *supra* note 39, at 462 (stating that the doctrine “vests extremely broad discretion in nonlegislative bodies to decide whether charitable entities are entitled to federal income tax exemption”).

of the Commissioner [of Internal Revenue]. This may be very well so long as one subscribes to the particular brand of social policy the Commissioner happens to be advocating at the time . . . but application of our tax laws should not operate in so fickle a fashion. Surely, social policy in the first instance is a matter for legislative concern.<sup>92</sup>

One scholar, Professor David Brennen, has argued that this lack of existing legal authority forced the *Bob Jones University* Court to rely on an expansive interpretation of “charitable” in § 501(c)(3) as justification for the IRS’s public policy power.<sup>93</sup> In disagreeing with such an expansive view of “charitable,” Brennen concludes that the Court’s decision failed to “address the limits of the Treasury’s ability to determine when or if a particular ‘public policy’ is sufficiently ‘established’ in any context other than whites discriminating against blacks.”<sup>94</sup> Accordingly, Brennen and other legal scholars have raised the fundamental issue of which sources of law or current policy the IRS should consult to determine to what extent a national public policy does or does not exist.<sup>95</sup>

While the Court looked to all three branches of government to conclude that an “established public policy” existed,<sup>96</sup> it is unclear whether this standard is too restrictive to be applied in all instances or if a broader view of public policy should be adopted; in other words, it is still unclear whether policy should be “established” without a clear consensus from all three governmental branches.<sup>97</sup> As discussed herein, do foreign policy and international law adopted by the United

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92. *Bob Jones Univ.*, 461 U.S. at 611–12 (Powell, J. concurring) (quoting *Alexander v. Ams. United* Inc., 416 U.S. 752, 774–75 (1974) (Blackmun, J., dissenting)); see also Galvin & Devins, *supra* note 39, at 1373 (“Justice Blackmun’s observation that too much administrative discretion may permit the IRS to administer tax laws in ‘so fickle a fashion’ continues to be a concern because the Internal Revenue Code is so pervasive in its application and the opportunity for abuse is so great.”); Michael Hatfield et al., *Bob Jones University: Defining Violations of Fundamental Public Policy*, in 6 TOPICS IN PHILANTHROPY 1, 14 (2000), available at <http://www1.law.nyu.edu/ncpl/pdfs/Monograph/Monograph2000BobJones.pdf> (“As both Justices Powell and Rehnquist point out, the ultimate balancing of interests belongs in the hands of Congress . . .”).

93. See Brennen, *supra* note 39, at 186–87.

94. Brennen, *supra* note 37, at 407.

95. See *id.* at 436–39; Buckles, *supra* note 39, at 408–32.

96. See *Bob Jones Univ.*, 461 U.S. at 598.

97. See HOPKINS, *supra* note 57, at 163 (“It may also be asserted that there is a federal public policy in the tax-exempt organization’s context, either presently in existence or in the process of development, against other forms of discrimination, such as discrimination on the basis of marital status, national origin, religion, handicap, sexual preference, and age.”).

States constitute norms sufficient to establish public policy?<sup>98</sup> Furthermore, it is unclear whether relative norms must exist for a period of time in order for a public policy to be “established.”<sup>99</sup> All of these uncertainties with respect to the existence of public policy illustrate the significant evidentiary burden placed on the IRS to prove that an organization’s activities violate a fundamental public policy.<sup>100</sup>

Another legal scholar, Professor Johnny Rex Buckles, has raised other flaws and inconsistencies with the public policy doctrine, some of which are particularly pertinent to this Article’s focus. First, Buckles points out that in *Bob Jones University*, the Court “did not decide whether an organization’s violation of law always results in denial (or revocation) of exemption.”<sup>101</sup> Accordingly, he opines that some distinction should be made between ongoing illegal activity and mere isolated acts, alluding to a similar distinction made by the IRS in a revenue ruling.<sup>102</sup> Buckles cautions against any interpretation of the public policy doctrine that would “deny exemption to every organization that engages more than insubstantially in illegal activities” because some illegal activities, such as prior laws that punished demonstrations against racial discrimination, may actually result in an “established public policy” (e.g., no racial discrimination in voting, the workplace, or education).<sup>103</sup> Buckles ultimately

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98. See, e.g., Buckles, *supra* note 39, at 426–32 (discussing whether state law norms should be considered in determining public policy).

99. See *id.* at 436–37.

100. See Hatfield et al., *supra* note 92, at 16. Beyond the evidentiary burden, the “IRS may also be loathe to jeopardize its own independence. Taking action against an organization for violating public policy, the IRS risks being reined in by the Congress or the President. Already unpopular, it may seem foolhardy to IRS officials to take a stand on controversial political issues.” *Id.* The IRS acknowledges this difficulty in its own training materials on the public policy doctrine: “Deciding a case on the basis of public policy rather than a specific law is difficult because it requires discerning what the public policy involved really is.” See JEAN WRIGHT & JAY H. ROTZ, INTERNAL REVENUE SERV., ILLEGALITY AND PUBLIC POLICY CONSIDERATIONS 9 (1993), <http://www.irs.gov/pub/irs-tege/eotopic194.pdf>.

101. Buckles, *supra* note 39, at 410.

102. See, e.g., Rev. Rul. 75-384, 1975-2 C.B. 204, 205 (“The intentional nature of this encouragement [to commit illegal acts] precludes the possibility that the organization might unfairly fail to qualify for exemption due to an isolated or inadvertent violation of a regulatory statute.”); Buckles, *supra* note 39, at 410–11; cf. I.R.S. Gen. Couns. Mem. 34,631, 1971 WL 28756, at \*5 (Oct. 4, 1971) (“If an organization carries on substantial illegal activities, it cannot qualify for exemption under section 501(c)(3) of the Code.”).

103. Buckles, *supra* note 39, at 413; see Johnny Rex Buckles, *Do Law Schools Forfeit Federal Income Tax Exemption When They Deny Military Recruiters Full Access to Career Services Programs?: The Hypothetical Case of Yale University v. Commissioner*, 41 ARIZ. ST. L.J. 1, 24–25 (2009).

concludes that the doctrine needs to be “limited and refined” and distinguish between “activities and purposes that are constitutionally protected and those that are not.”<sup>104</sup>

For instance, in Buckles’s opinion, the public policy doctrine should not be utilized to usurp an organization’s free speech, associative, and religious free exercise rights, provided that the organization otherwise qualifies under § 501(c)(3).<sup>105</sup> Undoubtedly, the Z Street exemption dispute, discussed in this Article’s introduction, would be one such instance where the doctrine should have no application due to the free speech implications. In response to concerns that application of the public policy doctrine may nevertheless fail to violate a constitutionally protected right, Buckles aptly phrases his interrogatory as “whether, *in the absence of specific statutory language*, the public policy doctrine should enable the IRS or a court to deny (or revoke) an entity’s federal income tax exemption on account of an activity that is constitutionally protected from direct prohibition.”<sup>106</sup>

Despite the public policy doctrine’s potentially limitless application, few scholars advocate scrapping the doctrine altogether.<sup>107</sup> For example, Professor Buckles raises “absurd” situations that would result if the doctrine were completely eliminated, referring to a tax-exempt charitable organization that uses illegal actions to accomplish its charitable purpose.<sup>108</sup> Ultimately, the absence of a clearly defined public policy and other flaws, as discussed above, force the IRS to balance its unfettered discretion in exercising public policy power with the heavy burden of proving that an “established” policy exists.

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104. Buckles, *supra* note 39, at 468.

105. *See id.* at 475.

106. *Id.* at 476.

107. *See, e.g.,* David A. Brennen, *Charities and the Constitution: Evaluating the Role of Constitutional Principles in Determining the Scope of Tax Law’s Public Policy Limitation for Charities*, 5 FLA. TAX REV. 779, 848–49 (2002); Brennen, *supra* note 37, at 446; Buckles, *supra* note 39, at 466–67; Galvin & Devins, *supra* note 39, at 1379–81.

108. Professor Buckles hypothesizes:

For an extreme example, assume that an organization created to promote world peace periodically hires sharpshooters to assassinate foreign and domestic military leaders perceived to perpetuate hostilities among nations. To assume that Congress intended to exempt this organization from federal income taxation merely because the promotion of peace is “charitable” and the statute does not explicitly prohibit exempt entities from behaving as terrorists is ludicrous.

Buckles, *supra* note 39, at 467 (footnote omitted).

This difficult balancing act may explain why the IRS has used the public policy doctrine as the basis for revocation only in instances involving racial discrimination, civil disobedience, or certain illegal activity.<sup>109</sup> However, the Z Street exemption dispute raises the possibility that the IRS views U.S. foreign policy as public policy, thus impacting a domestic organization's tax-exempt status. Once again, the lack of a clearly defined public policy leaves charitable organizations in the precarious position of monitoring the current political climate to ensure that their activities do not violate contemporary public policy, including, potentially, current U.S. foreign policy or international law.<sup>110</sup> Finally, the public policy doctrine's all-or-nothing application leaves charitable organizations that may have isolated or relatively minor public policy infractions vulnerable to a revocation of their tax exemption. Therefore, due to the increasing issues implicated by domestic charities' international activities, it is time for the doctrine to be both clarified and limited in its application and impact.

## II. EXAMINING THE PUBLIC POLICY DOCTRINE IN LIGHT OF GLOBALIZED PHILANTHROPY

### A. *U.S. Foreign Policy—Does It Constitute “Established Public Policy”?*

One aspect of the public policy doctrine that needs clarification is whether it applies to violations of current or established U.S. foreign policy. This Part discusses the difficulty in applying the doctrine to foreign policy and demonstrates why such application is problematic for domestic charities that operate internationally. Namely, equating U.S. foreign policy with “established public policy” would present significant administrative challenges and compliance burdens for these organizations.

The fundamental question of whether U.S. foreign policy constitutes “established public policy” is one that is not easily approachable. For example, is it determinative which branch or branches of government are responsible for formulating policy? This question, among others, necessitates the following discussion regarding which branch or branches of government have the

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109. See *supra* note 37 and accompanying text.

110. See Galvin & Devins, *supra* note 39, at 1373–74 (“[A]n organization’s survival may depend on the views of the particular administration in office.”).

authority for creating and maintaining foreign policy under the Constitution.

The Constitution divides responsibility for foreign policy among the executive and legislative branches; each serves important roles that differ and intersect. The Constitution is distinctly limited in its direction on foreign policy matters—it grants certain powers to the President, certain powers to the Senate, and other powers to Congress.<sup>111</sup> The President's enumerated powers are to: (1) make treaties with the "advice and consent of the Senate";<sup>112</sup> (2) nominate and, "by and with the advice and consent of the Senate," appoint ambassadors;<sup>113</sup> and (3) receive foreign ambassadors.<sup>114</sup> The President also has considerable implied and unenumerated power arising from the "executive power" granted to him by Article II.<sup>115</sup> Alexander Hamilton, among others, argued early on that this power "expressly conferred upon [the President] all authority over foreign relations, subject to only a few explicit exceptions."<sup>116</sup> Thomas Jefferson agreed that "[t]he transaction of business with foreign nations is *Executive altogether*."<sup>117</sup> Congress's enumerated powers are to: (1) regulate commerce with foreign nations; (2) define and punish piracy and felonies on the high seas; (3) declare war; and (4) establish rules on naturalization.<sup>118</sup> Congress's general, unenumerated powers are "indispensable to the conduct of foreign relations," including the power to tax and spend for the "common defense and general welfare."<sup>119</sup>

It is unsettled whether the executive or legislative branch "originates or finally determines" foreign policy.<sup>120</sup> This determination is not easily reached for several reasons. First, foreign policy is not "created in a vacuum as some sort of indivisible whole with a single grand design" but rather encompasses a protracted course comprised of numerous players and policies towards different

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111. RICHARD F. GRIMMETT, DEP'T OF STATE, FOREIGN POLICY ROLES OF THE PRESIDENT AND CONGRESS (1999), <http://fpc.state.gov/6172.htm>.

112. U.S. CONST. art. II, § 2, cl. 2.

113. *Id.*

114. *Id.* § 3; see LOUIS HENKIN, FOREIGN AFFAIRS AND THE UNITED STATES CONSTITUTION 35–37 (2d ed. 1996).

115. See HENKIN, *supra* note 114, at 39. Article II, Section 1 of the Federal Constitution provides: "The executive Power shall be vested in a President of the United States of America." U.S. CONST. art. II, § 1.

116. HENKIN, *supra* note 114, at 39.

117. *Id.* at 39 & n.11.

118. U.S. CONST. art. I, § 8, cl. 3, 4, 10, 11; see HENKIN, *supra* note 114, at 63–64.

119. HENKIN, *supra* note 114, at 64.

120. GRIMMETT, *supra* note 111.

countries and regions.<sup>121</sup> Second, due to this complex interaction of players and policies it is extremely difficult to conclude the person or persons that should be “credited with initiating or altering” any specific foreign policy.<sup>122</sup> Finally, “the roles and relative influence of the two branches in making foreign policy differ” occasionally based on such factors as the personalities and the political party affiliations of the President and members of Congress and the “degree of consensus on policy.”<sup>123</sup> For example, for decades leading up to the Vietnam War, the executive branch was the primary initiator of foreign policy.<sup>124</sup> After Vietnam, however, Congress “reasserted” its foreign policy role.<sup>125</sup> Notwithstanding, one study concluded that although Congress has more influence on foreign affairs than in most other countries, “the fact remains that the President is still in charge of American foreign policy.”<sup>126</sup>

One commentator has looked at the foreign policy roles of the President and Congress and the ways in which the executive branch and legislative branch can “originate or initially shape foreign policy.”<sup>127</sup> As to the President, there are six basic ways to create foreign policy, placing Congress in the position of either “responding positively to the President’s initiative or seeking to adjust or reverse the impact of his position.”<sup>128</sup> They are: (1) responding to foreign events (e.g., United States military actions in support of United Nations operations); (2) proposing legislation (e.g., foreign assistance programs); (3) negotiating international agreements (sometimes referred to as “executive agreements”);<sup>129</sup> (4) issuing statements on U.S. foreign policy; (5) implementing foreign policy legislation enacted by Congress; and (6) taking independent action.<sup>130</sup>

As to Congress, the commentator determined there are six basic ways in which the legislative body creates foreign policy, placing the executive branch in the position of either “responding positively to the congressional initiative or seeking to adjust or reverse the impact

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121. *Id.*

122. *Id.*

123. *Id.*

124. *See id.*

125. *Id.*

126. *Id.*

127. *Id.*

128. *Id.*

129. *See infra* note 152–55 and accompanying text for further discussion of executive agreements.

130. *See* GRIMMETT, *supra* note 111.



of his position.”<sup>131</sup> They are: (1) introducing and adopting resolutions and policy statements; (2) enacting legislation establishing a new foreign program, subject to the President’s ultimate approval and implementation; (3) applying pressure on the executive branch by threatening to enact certain legislation; (4) placing legislation prohibitions or restrictions on the President’s ability to act in foreign affairs (e.g., funding restrictions or legislation prohibiting certain actions); (5) providing informal advice to the executive branch; and (6) providing oversight over executive branch implementation of foreign policy (e.g., hearings and investigations).<sup>132</sup> One notable example of foreign policy articulated through legislation is the joint resolution of Congress in response to the September 11, 2001 terrorist attacks, which President George W. Bush signed into law.<sup>133</sup> On September 18, 2001, Congress authorized the President

to use all necessary and appropriate force against those nations, organizations, or persons he determines planned, authorized, committed, or aided the terrorist attacks that occurred on September 11, 2001, or harbored such organizations or persons, in order to prevent any future acts of international terrorism against the United States by such nations, organizations or persons.<sup>134</sup>

This resolution served as authority for President Bush to commence military action in Afghanistan to pursue al-Qaeda and was asserted by President Barack Obama as authority for his “surge” policy announced in late 2009.<sup>135</sup>

The creation and shaping of foreign policy is a complex and continual process and one that routinely lacks clarity and definition.<sup>136</sup>

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131. *Id.*

132. *See id.*

133. *See* Authorization for Use of Military Force, Pub. L. 107-40, 115 Stat. 224 (2011) (codified at 50 U.S.C. § 1541 (2006)).

134. *Id.* § 2(a).

135. *See* Bruce Ackerman & Oona Hathaway, *Did Congress Approve America's Longest War?*, THE GUARDIAN (Jan. 27, 2011), <http://www.guardian.co.uk/commentisfree/cifamerica/2011/jan/27/afghanistan-congress>; Rick Klein, *Key House Democrat: Obama Should Seek Congressional Approval for Afghanistan Surge*, ABCNEWS.COM (Dec. 2, 2009), <http://abcnews.go.com/blogs/politics/2009/12/key-house-democrat-obama-should-seek-congressional-approval-for-afghanistan-surge/>.

136. This Article does not specifically address the role of the Department of State in shaping foreign policy. As a department within the Executive Branch of the government, it falls under the direct purview of the President and likely is central to any foreign policy statements or executive orders issued by the President. For a more detailed discussion on the role of the Department of State in foreign policy and international law, see generally Richard B. Bilder, *International Law and United States Foreign Policy: Some Reflections*

Based on both the defined and undefined powers of the executive branch, foreign policy can easily be subject to the whims of the President and his or her expansive or nonexpansive view of “executive power.” As discussed above, foreign policy can be legislative in origin or adopted pursuant to an executive order issued by the President. Presidential executive orders are considered law within the executive branch until the current President or his successor modifies or repeals the order.<sup>137</sup>

For example, by Executive Order dated January 22, 2009, President Obama ordered the closure of the Guantanamo Bay facility within one year and required a review of the disposition of detainees before such closure, either by transfer to other countries, prosecution, or other disposition.<sup>138</sup> Therefore, executive orders, like legislative enactments described above, are more ascertainable sources of foreign policy than policy statements made by the President and, consequently, may be a more reliable and determinable source of “established public policy.” The Court relied on both sources of authority in *Bob Jones University*.<sup>139</sup>

However, executive orders can be rescinded the minute the officeholder changes, as is also the case with policy statements made by the President. With respect to policy statements, the President simply announces U.S. foreign policy with no readily available source such as a legislative act or an executive order. For example, President Obama announced on April 13, 2009, a series of changes in U.S. policy with respect to Cuba; in particular, the lifting of all restrictions on the travel of family members to Cuba and restrictions on remittances to family members in Cuba.<sup>140</sup> This Cuba policy, therefore, represents a statement of foreign policy with no corresponding legislative action or executive order.

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on the ASIL/ILA Report on the Role of the Legal Adviser, 1 TRANSNAT'L L. & CONTEMP. PROBS. 201 (1991).

137. See JOHN CONTRUBIS, CONG. RESEARCH SERV., NO. 95-722A, EXECUTIVE ORDERS AND PROCLAMATIONS 1-2 (1999), <http://www.llsdc.org/attachments/wysiwyg/544/crs-95-772.pdf> (“Often Presidents have relied upon Article II of the Constitution as the sole basis for issuing executive orders and proclamations.”); see also U.S. CONST. art. II, § 3 (“[The President] shall take care that the Laws be faithfully executed . . .”). The Federal Register Act requires that executive orders and proclamations be published in the Federal Register. See 44 U.S.C. § 1505 (2006).

138. See Exec. Order No. 13,492, 3 C.F.R. 13492 (2010).

139. See *Bob Jones Univ. v. United States*, 461 U.S. 574, 593-95 (1983).

140. See Memorandum from the Administration of Barack H. Obama to the Secretary of State, the Secretary of the Treasury, and the Secretary of Commerce, 2009 DAILY COMP. PRES. DOC. 257 (Apr. 13, 2009), available at <http://www.gpo.gov/fdsys/pkg/DCPD-200900257/pdf/DCPD-200900257.pdf>.

With the potential transience of executive orders and policy statements, it is extremely difficult for charities to determine whether their international activities or funding violate some U.S. foreign policy. As noted by one scholar addressing domestic charities' compliance with fairly hefty investigatory tasks pursuant to the Treasury Department's Anti-Terrorist Funding Guidelines,<sup>141</sup> most nonprofit organizations, and in particular smaller ones, are "not equipped to effectively carry out investigatory functions."<sup>142</sup> Consequently, it is a much more attenuated argument that such policies constitute established public policy.

This morass of U.S. foreign policies is a virtual minefield for domestic charities with any type or level of international activity. To mandate that such charities research every potential foreign policy implication of a proposed international activity is naïve, burdensome, and cost-prohibitive, especially for smaller charitable organizations. For these reasons alone, equating U.S. foreign policy with "established public policy" and potentially threatening a charitable organization's tax-exempt status on that ground is unfair and administratively unfeasible. Mandating that charitable organizations act consistently with U.S. foreign policy also results in significant compliance challenges for these organizations. Consequently, some system must be created whereby nonprofits may foresee that certain international activities may be deemed problematic from a tax exemption viewpoint. Then, instead of suffering the loss of their tax-exempt status, organizations could disclose their activities and have the opportunity to comply with the requirements of the Code. Through this process, domestic charities would receive adequate notice and have a more realistic opportunity for compliance.

*B. International Law as an Established Source of Public Policy*

International law may provide a more ascertainable source of public policy than U.S. foreign policy, but nevertheless presents similar compliance challenges. International law develops over time and is tested by duration and practice of sovereign states or nations. This area of the law is commonly viewed as having two component parts: public, addressing the relations between nations, and private, involving foreign transactions of both individuals and business

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141. See U.S. DEP'T OF THE TREASURY, ANTI-TERRORIST FINANCING GUIDELINES: VOLUNTARY BEST PRACTICES FOR U.S.-BASED CHARITIES (2005), <http://www.treasury.gov/press-center/press-releases/Documents/0929%20finalrevised.pdf>.

142. Gary W. Jenkins, *Soft Power, Strategic Security, and International Philanthropy*, 85 N.C. L. REV. 773, 827 (2007).

entities.<sup>143</sup> Because no formal international legislative, executive, or judicial forums exist, international law is not always readily identifiable. Nevertheless, it is usually regarded as being drawn from two primary sources, generally originating from the consent of nations.<sup>144</sup> The first primary source is agreements entered into between nations via treaties or conventions.<sup>145</sup> A second source of international law is the “customary practice” or “course of dealing” between nations, or “customary international law.”<sup>146</sup> A variation of customary international law is the concept that all nations observe certain legal norms that “are so fundamental as to be more or less automatically a part of international law,” often referred to as “general principles of law.”<sup>147</sup> The difficulty in attempting to define what constitutes international law reveals the initial complication in integrating this area of law into domestic tax exemption law. Furthermore, if international law is not easily defined or accessible, domestic charities are faced with a compliance quagmire.

One established component of international law is the agreements—treaties and conventions—that exist between nations. Under Article II of the Constitution, treaties ratified by the Senate constitute domestic law.<sup>148</sup> Article III of the Constitution includes within the scope of judicial power any cases arising under authorized treaties.<sup>149</sup> Finally, Article VI provides that authorized treaties shall be “the supreme law of the land.”<sup>150</sup> To further complicate matters, not all treaties having the benefit of Article VI are necessarily ratified under Article II; actually, most are not.<sup>151</sup> The great majority of

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143. See MARK W. JANIS, *AN INTRODUCTION TO INTERNATIONAL LAW* 2 (4th ed. 2003).

144. See *id.* at 4–5.

145. *Id.* at 5.

146. *Id.*

147. *Id.*

148. U.S. CONST. art. II, § 2, cl. 2.

149. *Id.* art. III, § 2 (“The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Law of the United States, and Treaties made, or which shall be made, under their Authority . . .”).

150. *Id.* art. VI, cl. 2 (“This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.”).

151. See JANIS, *supra* note 143, at 95. One treaty which the United States was instrumental in formulating but ultimately did not sign or ratify is the United Nations Convention on the Law of the Sea of October 7, 1982. *Id.* at 219. It took more than a decade for the necessary sixty states to ratify the treaty. *Id.* at 219–20. A major reason was a dispute over deep sea mining rights, the provisions for which were amended in 1994, garnering the adoption of many of the industrialized countries. *Id.* The official position of

international agreements into which the United States enters are executive agreements, not treaties.<sup>152</sup> These agreements are either statutory or “congressional-executive” agreements where the President acts according to legislation, or the President enters into agreements without any congressional involvement.<sup>153</sup> Although the Constitution does not specifically address executive agreements, their validity as international compacts has been upheld both by Supreme Court decisions and historical practice.<sup>154</sup> As one legal scholar commented, “[t]he power of the President or of the President and Congress to make international agreements outside the boundaries of Article II is a controversial and still-developing area of the law.”<sup>155</sup> As a result, the complexity surrounding international agreements and whether such agreements become the “supreme law of the land” raise numerous issues and extremely difficult compliance questions for domestic charitable organizations with international activities.

Considering the numerous types of treaties as well as the constitutional provisions applying to them, a fundamental question is whether a treaty benefitting from Article VI constitutes “established public policy” for purposes of the public policy doctrine. For example, the United Nations adopted and ratified the International Convention on the Elimination of All Forms of Racial Discrimination in 1965.<sup>156</sup> This international convention was ratified by the United States in October 1994 and entered into force on November 20,

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the United States is that the Convention provisions that protect high seas freedoms constitute “customary international law upon which the United States was entitled to rely,” but that it was not bound to those provisions relating to seabed rights because it did not sign or ratify the Convention. *Id.* at 225. As recently as July 2012, the Senate considered the treaty for ratification, but ultimately could not garner the necessary votes. See Keith Johnson, *GOP Scuttles Law-of-Sea Treaty*, WALL ST. J. BLOG (July 16, 2012, 5:06 PM), <http://blogs.wsj.com/washwire/2012/07/16/gop-opposition-scuttles-law-of-sea-treaty/>.

152. See HENKIN, *supra* note 114, at 215.

153. See JANIS, *supra* note 143, at 95.

154. See, e.g., *Am. Ins. Ass'n v. Garamendi*, 539 U.S. 396, 415 (2003) (“[O]ur cases have recognized that the President has authority to make ‘executive agreements’ with other countries, requiring no ratification by the Senate or approval by Congress, this power having been exercised since the early years of the Republic.”); *United States v. Belmont*, 301 U.S. 324, 330 (1937) (“[A]n international compact . . . is not always a treaty which requires the participation of the Senate.”); MICHAEL JOHN GARCIA & R. CHUCK MASON, CONG. RESEARCH SERV., R40614, CONGRESSIONAL OVERSIGHT AND RELATED ISSUES CONCERNING INTERNATIONAL SECURITY AGREEMENTS CONCLUDED BY THE UNITED STATES 2 (2012).

155. JANIS, *supra* note 143, at 96.

156. See G.A. Res. 2106 (XX), U.N. GAOR, 20th Sess., Supp. No. 14, U.N. Doc. A/6014, at 47 (Dec. 21, 1965).

1994.<sup>157</sup> If a domestic charity's international activities and funding are deemed to violate this international convention due to racial preference as with the Israeli settlements, should that charity's tax exemption be revoked because it violated the law and, thus, "established public policy"? Similarly, another commentator has argued that domestic charities' support of the Israeli settlements violates the Geneva Convention, which prohibits removing local population from an occupied territory and then moving the conquering country's population into that area.<sup>158</sup> Clearly, if these conventions constitute domestic law by operation of Article VI, then a violation thereof could implicate the public policy doctrine due to illegality. However, to date, the IRS has not issued any rulings or guidance addressing the probability that these types of violations trigger the doctrine.<sup>159</sup> Alternatively, in situations where an international law is not directly adopted by the United States via Article II, Article VI does not otherwise apply, or a foreign country's law is implicated, then current tax-exemption law is silent as to whether such a violation of international law is contrary to "established public policy" and thus could jeopardize the charity's tax-exempt status.<sup>160</sup>

As discussed in the context of U.S. foreign policy, international law is also a minefield for domestic charities involved in any kind of international activity. For charities, especially smaller organizations, determining the potential applicability of international law to their activities is burdensome and cost-prohibitive.<sup>161</sup> Again, equating the violation of any potentially applicable international law with illegality, thus implicating the public policy doctrine, would result in significant compliance challenges for charitable organizations.

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157. See Committee on the Elimination of Racial Discrimination, *Reports Submitted by States Parties under Article 9 of the Convention, Addendum, United States of America*, ¶ 3, U.N. Doc. CERD/C351/Add.1 (Sept. 21, 2000), available at <http://www.state.gov/documents/organization/100294.pdf>.

158. See Weirich, *supra* note 11, at 338.

159. See Brennen, *supra* note 37, at 391 n.2 (stating that the IRS has revoked tax-exempt status on the basis of public policy only in instances where the organizations participated in racial discrimination, civil disobedience, or an illegal activity).

160. See JAMES F. BLOOM, EDWARD D. LUFT, & JOHN F. REILLY, INTERNAL REVENUE SERV., FOREIGN ACTIVITIES OF DOMESTIC CHARITIES AND FOREIGN CHARITIES 14 (1992), <http://www.irs.gov/pub/irs-tege/eotopick92.pdf> ("It is settled that the conduct of illegal activities or activities that are contrary to public policy may jeopardize IRC 501(c)(3) exempt status regardless of the locus of the activity. What is not settled, however, is whether an activity conducted in a foreign country is illegal for IRC 501(c)(3) purposes because it is illegal under the laws of that country.").

161. See Jenkins, *supra* note 142, at 827, 835–37.

Clearly, as global philanthropy increases each year, U.S.-based charities need solid guidance with respect to their international activities.

### III. MOVING FORWARD—REFINING THE PUBLIC POLICY DOCTRINE TO ADDRESS CHARITIES' INTERNATIONAL ACTIVITIES

The preceding discussion on both foreign policy and international law and whether they constitute "established public policy" illustrates the potential challenges that exist for domestic charitable organizations in this international realm. As discussed by many scholars, the public policy doctrine is potentially limitless in its application due to the uncertainty over which "norms" constitute "established public policy."<sup>162</sup> This Part proposes two related solutions to address this possibility.

#### A. *Limited Codification of the Public Policy Doctrine*

One approach to addressing the public policy doctrine's potentially limitless application is to discard it completely. Although that approach has been examined, few scholars have concluded that elimination is the correct answer.<sup>163</sup> Nevertheless, scholars have consistently questioned whether it is appropriate for the IRS to determine what constitutes "established public policy."<sup>164</sup> In addition, some scholars have examined the inconsistency of the IRS's public policy power under *Bob Jones University* with past precedent, and the potential problems that arise with this authority under the nondelegation doctrine.<sup>165</sup> Essentially, the nondelegation doctrine "prevents Congress from delegating its legislative powers to another branch of government" such as the executive branch (and by delegation therein, the IRS).<sup>166</sup> In the public policy context, the nondelegation issue concerns the question of which governmental branch should determine what constitutes public policy.

In his concurring opinion in *Bob Jones University*, Justice Powell advocated that Congress, not the IRS, possessed the authority to

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162. See *supra* notes 93–100 and accompanying text.

163. See *supra* notes 107–08.

164. See *supra* notes 87–92 and accompanying text.

165. See Brennan, *supra* note 37, at 411, 413–27, and Buckles, *supra* note 39, at 443–59, for a more detailed discussion on these judicial and constitutional limitations.

166. Buckles, *supra* note 39, at 443. The doctrine emanates from the separation of powers set forth initially in Articles I, II, and III of the Constitution. See *id.* For example, Article I's "Vesting Clause" states, "All legislative Powers herein granted shall be vested in a Congress of the United States . . ." U.S. CONST. art. I, § 1.

determine public policy, balancing all the “substantial interests” at issue.<sup>167</sup> In evaluating the public policy doctrine in the context of racial discrimination, Professor Brennen concurred with Justice Powell’s conclusion, further noting:

In deciding where to strike the balance, Congress is empowered to conduct legislative hearings and examine societal perspectives and determine, for example, whether appropriate race-based affirmative action is necessarily against public policy. Moreover, democratic processes, not present in agency rulemaking, better ensure that Congress’s striking of this balance is reflective of the populace.<sup>168</sup>

Therefore, the reasonable conclusion is that the power to create, or determine the existence of, public policy rests with Congress, not an administrative agency like the IRS.

If elimination of the public policy doctrine is not a plausible solution, then Congress should validate the doctrine as a tenet of the charitable tax exemption via a well-tailored statutory codification. The doctrine’s codification would impose some ascertainable boundaries to the doctrine and finally provide indispensable guidance to domestic charities. Nevertheless, a codification of the broad *Bob Jones University* constraint—that a charitable organization shall not violate “established public policy”—potentially raises constitutional nondelegation concerns because, as Professor Buckles concluded, it still “invites an administrative agency . . . to articulate ‘established public policy,’ with absolutely no mention in any relevant revenue act of what policy is, let alone what affairs of national interest are even addressed by any such policy.”<sup>169</sup>

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167. See *Bob Jones Univ. v. United States*, 461 U.S. 574, 611 (1983) (Powell, J., concurring). Justice Powell stated:

[T]he balancing of these substantial interests is for *Congress* to perform. I am unwilling to join any suggestion that the Internal Revenue Service is invested with authority to decide which public policies are sufficiently “fundamental” to require denial of tax exemptions. Its business is to administer laws designed to produce revenue for the Government, not to promote “public policy.”

*Id.*

168. Brennen, *supra* note 37, at 426. Brennen further noted that Congress will not necessarily reach the “correct conclusion” in determining public policy, but Congress should “ideally” reach such conclusions “only after thoughtful and careful consideration.” *Id.* at 426 n.193.

169. Buckles, *supra* note 39, at 456–57. In evaluating certain Supreme Court decisions addressing the nondelegation doctrine, Professor Buckles raises concerns that a mere codification of the public policy doctrine as set forth in *Bob Jones University* will violate the main tenet of the nondelegation doctrine; namely that “[i]t provides no intelligible



To address these nondelegation concerns, Congress needs to not only codify the public policy doctrine, but also establish or define what constitutes public policy in the context of charitable organizations. It can statutorily provide broad outlines of what constitutes applicable public policy, such as racial discrimination, as well as specific sources of public policy, such as treaties and international conventions that have been ratified by the Senate under Article II of the Constitution. To address future public policy concerns, Congress could provide the IRS with statutory authority to implement a reportable transaction scheme, which it has employed in other areas of the Code such as prohibited tax shelters.<sup>170</sup> Such a scheme would provide Congress, and ultimately the IRS, with an ability to target or “list” certain domestic and international activities as inherently in conflict with tax-exempt status under § 501(c)(3) (i.e., “listed transactions”). As with the current reportable transaction scheme in place for certain tax shelter transactions, a charitable organization involved in any listed transaction would be required to disclose that transaction to the IRS.<sup>171</sup> The benefit of this disclosure regime is twofold. It makes the IRS increasingly aware of certain types of problematic transactions so greater guidance can be provided, and it also grants the IRS an enforcement tool for violations, as discussed below. The courts, however, will unquestionably “remain the final arbiters”<sup>172</sup> of whether the IRS has utilized this reportable transaction scheme in accordance with congressional intent.

Addressing the public policy dilemma through legislation will not be an easy task for Congress. Nonetheless, charities’ increasing participation in international activities alone necessitates a

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principle, based upon an expressed legislative policy, to limit the actions of the Treasury Department in general or the IRS in particular.” *Id.* at 457; *see also* *Whitman v. Am. Trucking Ass’ns*, 531 U.S. 457, 474 (2001) (stating that Congress must put forth an intelligible principle when it confers decisionmaking authority and has failed in only two instances: where it provided “literally no guidance” and where it delegated authority over “the entire economy”); *Yakus v. United States*, 321 U.S. 414, 424–25 (1944) (stating that Congress permissibly delegated authority when it “specified the basic conditions of fact upon whose existence or occurrence . . . it directs that its statutory command shall be effective”).

170. *See* I.R.C. §§ 4965(e), 6707A(c) (2006). A “reportable transaction” is defined as “any transaction with respect to which information is required to be included with a return or statement because, as determined under regulations prescribed under section 6011, such transaction is of a type which the Secretary determines as having a potential for tax avoidance or evasion.” *Id.* § 6707A(c)(1).

171. *See, e.g., id.* §§ 6011(g), 6111(a); Treas. Reg. §§ 1.6011-4(a) (as amended in 2010), 301.6111-3 (as amended in 2011).

172. *See* Buckles, *supra* note 39, at 477.

congressional response and a determination of public policy parameters going forward. As Justice Powell also stated in his *Bob Jones University* concurrence, the boundaries of the public policy doctrine clearly rest with Congress:

Many questions remain [unanswered by the Court], such as whether organizations that violate other [public] policies should receive tax-exempt status under § 501(c)(3). These should be legislative policy choices. It is not appropriate to leave the IRS “on the cutting edge of developing national policy.” The contours of public policy should be determined by Congress, not by judges or the IRS.<sup>173</sup>

Therefore, this Article joins the chorus of other scholars and commentators calling upon Congress to finally address this public policy conundrum.

*B. Excise Tax Regime as an Alternative Enforcement Tool for Public Policy Violations*

The codification of the public policy doctrine should also include an excise tax to address public policy violations that are isolated and/or minor in relation to a charitable organization’s overall tax-exempt activities. As Professor Buckles has noted, the Supreme Court in *Bob Jones University* did not address whether a charitable organization’s violation of law “always results in denial (or revocation) of exemption.”<sup>174</sup> Actually, as Buckles further illustrated, the Supreme Court explicitly alluded to the possibility that a charitable organization may violate a law or public policy yet nevertheless confer an overall public benefit, but stopped short of concluding that it would violate the public policy doctrine.<sup>175</sup> Buckles furthermore raised the issue that “[p]erhaps isolated acts [of public policy violations] should be adjudicated differently from a pattern of

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173. *Bob Jones Univ. v. United States*, 461 U.S. 574, 612 (1983) (Powell, J. concurring) (citation omitted).

174. See Buckles, *supra* note 39, at 410.

175. *Id.*; see also *Bob Jones Univ.*, 461 U.S. at 596 n.21 (“In view of our conclusion that racially discriminatory private schools violate fundamental public policy and cannot be deemed to confer a benefit on the public, we need not decide whether an organization providing a public benefit and otherwise meeting the requirements of § 501(c)(3) could nevertheless be denied tax-exempt status if certain of its activities violated a law or public policy.”).

illegal behavior.”<sup>176</sup> Even the IRS has intimated that isolated illegal acts may be less fatal to exempt status.<sup>177</sup>

Fundamentally, an excise tax regime would serve as an alternative to revocation of tax-exempt status for these isolated public policy violations. To illustrate, assume that a domestic charitable organization conducts educational and charitable activities that support the nation of Israel, targeting funds to schools, community centers, and synagogues. However, the organization sent \$1,000,000 in 2010 to support East Jerusalem settlements, which is now a listed transaction (i.e., violates “established public policy”) under the new statutory regime discussed above. Under this excise tax system, similar to other excise taxes imposed on public charities under § 4958 or private foundations under § 4941, the IRS can impose an excise tax on the organization and potentially require correction of the prohibited activity—for instance, that the organization recoup the funds to the extent possible and forgo any additional activities of this kind in the future.<sup>178</sup> As with other excise tax regimes currently in place, the assessed tax would be greater if the organization knew or had reason to know that the channeling of its funds constituted a prohibited transaction.<sup>179</sup> Congress need not create a new excise tax for public policy violations; rather, it can utilize § 4965, which subjects certain tax-exempt entities to an excise tax for becoming parties to prohibited tax shelter transactions.<sup>180</sup> The meaning of “prohibited tax shelter transaction” is defined in a cross-referenced section on reportable transactions in the tax shelter context.<sup>181</sup> The statute could be amended to similarly subject certain listed transactions to the excise tax under the new statutory scheme described above. Although § 4965 does not currently contain any provisions on correction of the prohibited transaction, Congress can easily amend the section to provide for correction with respect to listed transactions involving public policy violations.

The imposition of this excise tax on public policy violations, like the excise tax on excess benefit transactions under § 4958, provides the IRS with an “intermediate sanction” alternative to revoking an

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176. Buckles, *supra* note 39, at 410.

177. See Rev. Rul. 75-384, 1975-2 C.B. 204, 205 (“The intentional nature of this encouragement [to commit illegal acts] precludes the possibility that the organization might unfairly fail to qualify for exemption due to an isolated or inadvertent violation of a regulatory statute.”).

178. See, e.g., I.R.C. §§ 4941(e)(3), 4958(f)(6) (2006).

179. See *id.* §§ 4941(a)(1), 4958.

180. See *id.* § 4965(a).

181. *Id.* § 4965(e)(1).

organization's tax-exempt status for isolated or minor public policy violations. The excise tax would allow the organization to continue its many other exempt purpose activities and not adversely affect either the charitable programs it administers or the charitable class that benefits from those programs.

### C. *Difficulties and Potential Criticisms*

These proposals—codification of the public policy doctrine along with a reportable transaction scheme and an excise tax enforcement tool—are not without pitfalls and criticisms. The primary criticism is that this will add another layer of legal requirements for, and regulation of, charitable organizations and will actually increase IRS participation and oversight. Clearly, additional regulation and less autonomy for charitable organizations is a valid concern.<sup>182</sup> However, this Article is more concerned with the potentially limitless application of the public policy doctrine, particularly in the international realm, and the lack of overall guidance with respect to the impact of international activities on domestic tax exemption. Elimination of a potential plethora of issues for charitable organizations with international activities is arguably preferable and may be a fair tradeoff for potentially greater regulation. If Congress and the IRS issue sufficient guidance, charities can comply and avoid troublesome activities, thereby precluding the need for excessive IRS oversight. Furthermore, charities involved in international grant-making are already advised to regularly monitor the Specially Designated Nationals list maintained by the Treasury Department's Office of Foreign Assets Control to ensure they are not directly or indirectly supporting terrorist organizations and, thus, risking automatic suspension of their tax-exempt status.<sup>183</sup> Therefore, charities operating in the international realm are already equipped—

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182. See generally Evelyn Brody & John Tyler, *Respecting Foundation and Charity Autonomy: How Public Is Private Philanthropy?*, 85 CHI.-KENT L. REV. 571, 616 (2010) ("Clearly, impairing the independence, autonomy and fundamentally private nature of foundations and other charities could have serious consequences for them, the sector, and broader society, particularly if grounded on a theory that lacks meaningful support in law, history, or policy.").

183. See J. Christine Harris, *IRS Explains Current Developments Concerning Charities*, OMBWATCH (Nov. 22, 2004), <http://www.ombwatch.org/node/4499>. See *supra* note 5 and accompanying text for a brief discussion of tax exemption suspension due to support of a terrorist organizations pursuant to § 501(p). A description of the Treasury Department's Office of Foreign Assets Control as well as a link to the Specially Designated Nationals list is available at <http://www.treasury.gov/about/organizational-structure/offices/Pages/Office-of-Foreign-Assets-Control.aspx>.

to some extent—to monitor both guidance and reportable transactions targeting certain international activities.

The IRS appears to be acutely aware of the tightrope it must walk with respect to charities and their international activities. As one tax law specialist acknowledged with respect to charities and terrorist organizations guidance in 2004, the IRS has a “fine line to dance” in safeguarding charitable funds from ending up with terrorist organizations, but “at the same time, we must avoid taking actions that will inadvertently hurt the charitable communities’ ability to provide funds and services in places . . . that have a great need for charitable giving.”<sup>184</sup> It seems reasonable to conclude that the IRS would apply that same sensitivity in utilizing any reportable transaction mechanism enacted by Congress in the public policy doctrine context. The court system will provide the ultimate check to IRS actions in this realm.<sup>185</sup> Finally, uniform treatment of charitable organizations and overall compliance by such organizations are potential benefits of these proposals that can counterbalance any regulatory and compliance burdens.

Another criticism is that this public policy concern, especially in the international context, is insignificant.<sup>186</sup> Again, the potential plethora of issues facing charitable organizations in the international realm cannot be underestimated or overly discounted. Although educated minds can disagree over whether the Z Street controversy implicitly raises a public policy issue, the mere possibility that it might represent a merger of public policy with foreign policy or international law should be sufficiently disconcerting to warrant further exploration and discussion. Ultimately, this Article’s proposals are not intended to preclude necessary discussion of the real issues confronted by charities with respect to their international activities. Specifically, it is likely that the proposals set forth herein are not the only avenues to a viable solution. Because so much of international law, including U.S. foreign policy, involves “policy,” the public policy doctrine seems to be one natural path to a solution. Furthermore, with so many scholars having called for Congress to address the public policy doctrine and its flaws, with some necessary boundaries,<sup>187</sup> the international law and policy issues confronting charities offer even more reasons for Congress to finally confront the public policy doctrine conundrum. Nevertheless, this Article’s

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184. Harris, *supra* note 183.

185. See *supra* note 172 and accompanying text.

186. See Buckles, *supra* note 39, at 460.

187. See sources cited *supra* note 107.

primary purpose is to confront some of the difficulties that may confront charities operating in the international realm, raise further awareness to these issues, and offer some potential solutions that will hopefully engender additional discussion.

#### CONCLUSION

As global philanthropy continually increases, domestic charities need solid guidance with respect to their international activities, including whether the public policy doctrine is implicated. This Article has examined the public policy doctrine as the one component of charitable exemption law that is potentially implicated by charities' international activities. However, the doctrine, which can be utilized by the IRS to deny or revoke a charitable organization's tax-exempt status, lacks definition with respect to its scope, sources of public policy, and the IRS's authority to determine what constitutes "established public policy."

This Article agrees with other legal scholars that the doctrine cries out for congressional attention, especially considering the international law and policy issues potentially implicated by the doctrine. Nevertheless, the automatic inclusion of U.S. foreign policy and international law as components of "established public policy" would be both administratively impracticable and onerous and would result in significant compliance difficulties for charitable organizations. The potential transience of U.S. foreign policy and the difficulty in defining what constitutes international law both illustrate the initial complexity of integrating these into domestic tax exemption law.

Accordingly, this Article proposes congressional action with respect to the doctrine, accompanied by a reportable transaction scheme and excise tax as additional enforcement tools. Ultimately, if Congress and the IRS can issue comprehensive and clear guidance, charities can comply and avoid troublesome international activities, hopefully leading to minimal, but necessary, IRS oversight. The ultimate goal should be to ensure that charitable organizations can continue to provide funds and services to the international communities and causes that need it the most.

