BENEFIT CORPORATIONS— THE LATEST DEVELOPMENT IN THE EVOLUTION OF SOCIAL ENTERPRISE: ARE THEY WORTHY OF A TAXPAYER SUBSIDY? *

*Mystica M. Alexander***

* A draft version of this paper was presented at the Huber Hurst Seminar at the University of Florida. The author would like to thank those participating at the seminar for their guidance on this project. The author is also grateful for the assistance of Gerald Ferrera, Jonathan Darrow, David Orozco, Cheryl Kirschner, John Hayward, and Michael Alexander-Yang.

** Assistant Professor, Department of Law, Taxation, and Financial Planning, Bentley University, Waltham, Massachusetts.

I. INTRODUCTION

In 1978, when Bennett Cohen and Jerry Greenfield invested $12,000 in an ice cream venture and started selling ice cream from a renovated gas station in Burlington, Vermont, they did not envision that only six years later, they would be generating $4 million in annual sales.[1] Ben & Jerry's reputation as a company with a quality product and a dual mission of social conscience and profit kept them both in the headlines and profitable. To expand their operations, Bennett and Jerry sold shares to the public in 1984 and 1985.[2] In 2000, Unilever offered to buy the company at $43.60 per share (for a total sale price of $326 million)— a bid well above the competing take-over bids for the company.[3] While Bennett and Jerry had reservations about whether a parent company such as Unilever would stay true to the social-minded ideals the pair had worked hard to maintain, they believed that they had a duty to maximize shareholder value by accepting the take-over bid.[4]

According to Greenfield, "[i]t was a very difficult time. But we were a public company, and the Board of Directors' primary responsibility is the interest of the shareholder. So that is what the decision came down to. It was extremely difficult, heart-wrenching."[5] In the year 2000, there was no for-profit hybrid business model available to social-minded business owners that would provide them with an affirmative duty to consider the interests of stakeholders, rather than just shareholders, in their corporate decision-making. But today, in a growing number of states, that problem has changed. A new form of hybrid business, known as the Benefit Corporation, would have provided Ben & Jerry's with the focus its founders sought.

The Benefit Corporation allows corporate directors to consider

1 Lauren Folino, *The Great Leaders Series: Ben Cohen and Jerry Greenfield, Co-founders of Ben & Jerry's Homemade*, INC.COM (Feb. 18, 2010), http://www.inc.com/30years/articles/ben-and-jerry.html.

2 Anthony Page & Robert Katz, *Freezing Out Ben & Jerry: Corporate Law and the Sale of a Social Enterprise Icon,* 35 VT. L. REV. 211, 218-19 (2010).

3 Dan Gallagher, *Dryer's Loses Ben & Jerry's Ice Cream Bid to Unilever*, SAN FRANCISCO BUS. TIMES (Apr. 14, 2000 9:00pm PDT), http://www.bizjournals.com/eastbay/stories/2000/04/17/story2.html.

4 Page, *supra* note 2, at 229.

5 Hannah Pool, *Question Time with Hannah Pool*, GUARDIAN (July 31, 2008), http://www.guardian.co.uk/business/2008/jul/31/5.

social missions and objectives, as well as profits, in carrying out their fiduciary duties. Benefit Corporations provide shareholders with "additional rights to hold directors accountable for failure to create material positive impact on society or to consider the impact of decisions on employees, community, and the [local and global] environment."[6] While Benefit Corporations are relatively new and untested entities, they hold great promise for encouraging and allowing an increasing number of companies to operate with a focus not only on profits but also on the impact of company actions on a broad array of stakeholders.

Maryland was the first state to pass Benefit Corporation legislation in April of 2010.[7] Since that time, the District of Columbia and an additional twenty-five states have passed similar legislation.[8] Benefit Corporation legislation is also pending in twelve other states.[9] Currently, Benefit Corporations do not receive any preferred federal tax treatment.

The purpose of this Article is twofold: (1) placing the Benefit Corporation within the historical context of the social enterprise movement in the United States, and (2) considering whether Benefit Corporations should qualify for the preferred tax treatment given to nonprofit organizations. Part II of this Article explores the evolution of the social enterprise movement and the path leading to the hybrid entity's rise in the United States. Part III provides a closer look at the legal requirements imposed on Benefit Corporations. Part IV outlines the requirements that must be met for a nonprofit organization to qualify for tax benefits and the rationale behind such benefits. Part V

[6] *Press Release, The Corporate Social Responsibility Newswire: Maryland First State in Union to Pass Benefit Corporation Legislation* (Apr. 14, 2010 10:57 AM EST), http://www.csrwire.com/press_releases/29332-Maryland-First-State-in-Union-to-Pass-Benefit-Corporation-Legislation.

[7] *Id.*

[8] These include: Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Hawaii, Illinois, Louisiana, Massachusetts, Minnesota, Nebraska, Nevada, New Hampshire, New Jersey, New York, Oregon, Pennsylvania, Rhode Island, South Carolina, Utah, Vermont, Virginia, and West Virginia. *See* State by State Legislative Status, BENEFIT CORP. INFORMATION CENTER, http://benefitcorp.net/state-by-state-legislative-status. http://benefitcorp.net/state-by-state-legislative-status (legislation that has been passed in Connecticut, Florida, and New Hampshire is still awaiting the signature of the governor).

[9] These include: Alaska, Alabama, Georgia, Idaho, Indiana, Iowa, Kansas, Kentucky, Michigan, Montana, Ohio, and Wisconsin. *See id.*

addresses whether the tax benefits made available to nonprofit organizations should be extended to Benefit Corporations. This Article concludes that although the Benefit Corporation represents a natural progression in the evolution of social enterprise, its organizational and operational structure does not provide sufficient grounds for extending special tax treatment to these organizations.

II. THE HYBRID ENTITY EVOLVED FROM THE SOCIAL ENTERPRISE MOVEMENT

In 1970, Milton Friedman assured us: "There is one and only one social responsibility of business— to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud."[10] In 1984, R. Edward Freeman wrote a book called *Strategic Management: A Stakeholder Approach*, which popularized the phrase "stakeholder theory" and the idea that a corporation should consider the ramifications of its actions, not just on its shareholders, but on all those impacted by corporate decisions.[11] Several years later, in 2005, Whole Foods CEO John Mackey offered the following perspective: "Someday businesses like Whole Foods which adhere to a stakeholder model of a deeper business purpose will dominate the economic landscape. Wait and see."[12] In his 2009 Encyclical Letter, *Caritas in Veritate*, Pope Benedict XVI considered the relationship between business and ethics and concluded that "the traditionally valid distinction between profit-based companies and nonprofit organizations can no longer do full justice to reality or offer practical direction for the future," and called for the recognition of "a broad new composite reality embracing the public and private spheres, one which does not exclude profit, but

[10] Milton Friedman, *The Social Responsibility of Business Is to Increase Profits*, N.Y. TIMES MAG. (Sept. 13, 1970), http://www.colorado.edu/studentgroups/libertarians/issues/friedman-soc-resp-business.html.

[11] R. Edward Freeman, STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH 47-8 (2010).

[12] *Rethinking the Social Responsibility of Business*, REASON MAG. (Oct. 2005), http://reason.com/archives/2005/10/01/rethinking-the-social-responsi/singlepage.

instead considers it a means for achieving human and social ends."[13]

At present, we increasingly find ourselves moving away from the Friedman approach and toward the John Mackey view of the role of the corporation. The 2008 financial crisis having global repercussions, the distrust of Wall Street resulting from the crisis, and the seemingly never-ending headlines of a new corporate scandal have caused many people to question and rethink the proper role of the corporation.[14] Should corporations be purely profit driven entities, first and foremost serving the financial interest of shareholders? Not surprisingly, in the United States, this very question has been brought to the forefront. Co-founder of B-Lab Jay Gilbert has addressed this, "With public trust in business at an all time low, [benefit corporations] represent the first systemic response to the underlying problems that created the financial crisis."[15] State legislatures and their constituents who recognize the value of the expansion of the corporate social conscience have increasingly accepted the Benefit Corporation. Although recent events have certainly accelerated the acceptance of these hybrid entities, the concept of this business model has been many years in the making.

[13] Pope Benedict XVI, Encyclical Letter, *Caritas in Veritate* ¶ 46 (June 29, 2009), http://www.vatican.va/holy_father/benedict_xvi/encyclicals/documents/hf_ben-xvi_enc_20090629_caritas-in-veritate_en.html. This Encyclical attracted the attention of the international media according to Bill Moyers Journal. *See The Pope's Encyclical: Charity in Truth*, July 7, 2009, http://www.pbs.org/moyers/journal/07032009/profile4.html (citing the following examples of international media attention: *Pope Calls for God-Centered Global Economy*, USA TODAY, July 7, 2009; *Post Litteram*, RELIGION NEWS SERVICE, July 7, 2009; *Pope Benedict on Economic Justice: The Catholic's View*, WASH. POST, July 7, 2009; *Pope Benedict Appeals for Less Greed and More Soul*, DEUTSCHE WELLE, July 7, 2009; *Encyclical Covers Issues from Sex to World Economy*, GUARDIAN [UK], July 7, 2009).

[14] *See, e.g.*, Erik Eckholm and Timothy Williams, *Anti-Wall Street Protests Spreading to Cities Large and Small*, N.Y. TIMES (Oct. 3, 2011), http://www.nytimes.com/2011/10/04/us/anti-wall-street-protests-spread-to-other-cities.html?_r=0; Jesse Eisinger, *Financial Crisis Suit Suggests Bad Behavior at Morgan Stanley*, N.Y. TIMES, (Jan. 23, 2013), http://dealbook.nytimes.com/2013/01/23/financial-crisis-lawsuit-suggests-bad-behavior-at-morgan-stanley/; Sewell Chan, *Financial Crisis was Avoidable, Inquiry Finds*, N.Y. TIMES (Jan. 25, 2011), http://www.nytimes.com/2011/01/26/business/economy/26inquiry.html.

[15] B CORPORATION, 2011 ANNUAL REPORT 17 (2011), https://www.bcorporation.net/news-media/annual-report-2011 (quoting Jay Coen Gilbert, co-founder of B Lab).

A. The Notion of Corporate Philanthropy as a Remedy for Social Ills Has Been in Place for Over a Century

The notion of joining nonprofit and for-profit objectives is not new. Over a century ago, "beginning with the creation of The Carnegie Corporation in 1911 and the Rockefeller Foundation in 1913, the modern philanthropic foundation came into existence."[16] There was a recognition that those generating wealth had a responsibility to use that wealth to benefit society. Private foundations "arose as an institutional response to the rapid social, economic, and cultural changes of the late nineteenth and early twentieth century."[17] Before this time, charitable efforts were generally focused on discrete local issues, but new foundations represented a more managerial and bureaucratic approach to broad social concerns.[18] There are now approximately 2,700 corporate foundations in the United States, which made grants of approximately $5.2 billion in 2010.[19] Today's high profile foundations, such as the Bank of America Charitable Foundation and the GE Foundation, highlight the close relationship that can exist between the for-profit entity and the nonprofit organization.[20] Moreover, nonprofit organizations might create a for-profit enterprise to serve their purposes. For example, a nonprofit can set up a for-profit retailer to sell its merchandise.[21]

Nonprofits have also successfully entered into joint venture arrangements with for-profit corporations. In Revenue Ruling 98-15, the IRS decided that a nonprofit organization and a for-profit corporation could engage in a joint venture using a Limited Liability Company ("LLC") as long as the arrangement was properly

[16] Barry D. Karl & Stanley N. Katz, *The American Private Philanthropic Foundation and the Public Sphere 1890-1930*, 19 MINERVA 236, 246 (1981).

[17] Carl J. Schramm, *Law Outside the Market: The Social Utility of Private Foundations*, HARV. J.L. & PUB. POL'Y 356, 368 (2006).

[18] *Id.*

[19] *Key Facts on Corporate Foundations August 2012*, FOUNDATION CTR., http://foundationcenter.org/gainknowledge/research/pdf/keyfacts_corp2012.pdf (last visited Dec. 5, 2013).

[20] The GE Foundation is the philanthropic arm of GE, http://www.gefoundation.com/; Bank of America's Neighborhood Builders Program is the country's "largest philanthropic investment in nonprofit leadership investment," http://www.gefoundation.com/.

[21] Allen Bromberger, *A New Type of Hybrid*, STAN. SOC. INNOVATION REV., Spring 2011, at 49–53.

structured.[22] The ruling presents two scenarios, each one involving a nonprofit hospital that forms an LLC with a for-profit corporation.[23] The for-profit corporation provided financing for the arrangement.[24] The nonprofit contributed its hospital and other assets to the LLC and the LLC then operated the hospital.[25] Although both scenarios are premised on these same basic facts, one protects the nonprofit's 501(c)(3) status and the other puts that status in jeopardy. The table below highlights the key distinctions in the two scenarios:

Table 1: Revenue Ruling 98-15 Two Scenario Distinctions[26]

Attribute	Scenario One	Scenario Two
Mission	The governing instrument of the LLC states that the hospital will be operated "in a manner that furthers charitable purposes by promoting health for a broad cross-section of its community."	The LLC's governing instrument does not give priority to the charitable purposes of the exempt organization.
Governance	The exempt entity controls three of the five seats on the governing board. The governing body has authority over major decisions. Distributions to for-profit controlled by nonprofit.	The exempt provider and the nonprofit corporation share control, with each having the same number of seats. The governing body has authority over major decisions.
Management	The joint venture contracts with an independent third party to manage the hospital.	The joint venture contracts with a wholly-owned subsidiary of the for-profit corporation to manage the hospital.

The IRS's focus on these distinctions clearly indicates that the overriding concern in reviewing such ventures is the degree to which

22 Rev. Rul. 98-15, 1998-12 I.R.B. 6.

23 *Id.* at 6.

24 *Id.*

25 *Id.*

26 David S. Walker, *Business Organizations: When "Business Purpose" Disappears: Article: A Consideration of an LLC for a 501(c)(3) Nonprofit Organization,* 38 WM.. MITCHELL L. REV. 627.

the control and direction of the venture reflects the nonprofit organization's participation. Situation two jeopardized the nonprofit's tax-exempt status because control was shared, the for-profit entity essentially managed the business, and there was no commitment to ensure the priority of charitable activity.[27] By contrast, the first scenario met all the ideals of a qualifying joint venture.

While this ruling is instructive in that it makes clear that nonprofits can engage in joint ventures with for-profits, it is also somewhat limited because it represents two extreme positions: one in which everything is just right, and one in which everything is just the opposite. Reality usually lies somewhere in between, so practitioners are left to evaluate the facts and circumstances of a particular scenario to see if the activity is permissible.

To assist practitioners in this regard, the IRS issued Revenue Ruling 2004-51 to address a variation of control in the nonprofit/for-profit venture.[28] In that ruling, a nonprofit university contributed a portion of its assets to an LLC, through which it engaged in a joint venture with a for-profit corporation.[29] The LLC was formed to offer teacher-training sessions at off-campus locations through video technology.[30] The for-profit corporation had expertise in video training programs.[31] The university provided the curriculum, similar to what it used for its on-campus summer programs.[32] The nonprofit and for-profit organizations had an equal number of votes on the governing board.[33] The entities divided their responsibilities as follows: the nonprofit university was responsible for approval of curriculum, training materials, and instructors, and the for-profit was responsible for selecting the seminar location and approving other necessary personnel.[34] The IRS determined that this arrangement did not jeopardize the university's nonprofit status, because the activities the university conducted through the LLC were not a substantial part

[27] *Id.* at 17-18.
[28] Rev. Rul. 2004-51, 2004-22 I.R.B.
[29] *Id.*
[30] *Id.*
[31] *Id.*
[32] *Id.*
[33] *Id.*
[34] Rev. Rul. 2004-51, 2004-22 I.R.B.

of its activities.[35] Further, the Service noted that the activities of the LLC were substantially related to the university's exempt purpose, and therefore, would not result in taxable unrelated business income to the university.[36]

Another area of overlap of for-profit and nonprofit entities is social alliance. Social alliances (relationships in which a for-profit and nonprofit share resources and capabilities) have proven to be beneficial to both entities that enter into this relationship.[37] For example, an alliance between the Oakland Athletics baseball team and the Oakland Ballet Company allowed the Oakland Athletics to increase their community involvement while maintaining their visibility during the off-season.[38] The alliance also caused an increase in ticket sales for the Oakland Ballet and an increase in the organization's attractiveness to other local businesses.[39]

Although for-profit corporations can and do engage in activities with nonprofit organizations, there has always been an inherent risk of blurring the nonprofit/for-profit distinction for both entities. Nonprofits risk the loss of tax-exemption and the receipt of unrelated business income. For-profit entities risk shareholder complaints and lawsuits for a failure to maximize profits.

Henry Ford learned this lesson when he announced his intention to use the benefits derived from his successful business venture to help ensure the betterment of a broad spectrum of individuals rather than just his shareholders.[40] In response to a legal challenge filed by shareholders of the Ford Corporation, a court ultimately ordered the Ford Corporation to declare a special dividend to the shareholders.[41] At the turn of the century, the stage was not quite set for the stakeholder approach, but that soon began

[35] *Id.*

[36] *Id.*

[37] Larry Weinstein & John Cook, *The Benefits of Collaboration Between For-Profit Businesses and Nonprofit Arts-or-Culture-Oriented Organizations,* SAM Advanced Management Journal 4 (2011).

[38] Philip Kotler, STANDING ROOM ONLY: STRATEGIES FOR MARKETING THE PERFORMING ARTS 178 (1997).

[39] *Id.*

[40] Matthew F. Doeringer, *Fostering Social Enterprise: A Historical and International Analysis*, 20 DUKE J. COMP. & INT'L L. 291, 304 (2010).

[41] Dodge v. Ford Motor Co., 170 N.W. 668, 678 (Mich. 1919).

to change. In 1932, Harvard Law Professor E. Merrick Dodd proposed that corporations had a societal obligation that extended beyond the shareholders.[42] A few years later, in 1950, the American Bar Association amended the Model Business Corporation Act to acknowledge that corporate contributions to charities were a permissible means of enhancing corporate well being and reputation.[43]

At present, there is a genuine debate in the legal community as to whether shareholder wealth maximization principles advocated by the court in *Dodge v. Ford* remain a viable position.[44] If those who believe that shareholder wealth maximization is no longer an absolute requirement for corporations are correct, then perhaps Benefit Corporations are not as necessary as advocates claim.

While both the Business Judgment Rule and state constituency statutes support the position that corporations already have the ability to conduct activities with a social benefit purpose, these protections do not offer the same level of protection to directors as the Benefit Corporation. The Business Judgment Rule insulates directors from liability to shareholders for decisions made with care and in good faith. Under this rule, "a court will not second guess the decisions of a director as long as they are made (1) in good faith, (2)

[42] E. Merrick Dodd, *For Whom Are Corporate Managers Trustees*? 45 HARV. L. REV. 1145, 1148 (1932).

[43] R. Franklin Balotti & James J. Hanks, Jr., *Giving at the Office: A Reappraisal of Charitable Contributions by Corporations*, 54 BUS. LAW. 965, 969 (1999).

[44] *See*, *e.g.*Lynn A. Stout, *Why We Should Stop Teaching Dodge v. Ford*, 3 VA. L. & BUS. REV. 163, 168, 174 (2008) (maintaining that "shareholder wealth maximization is not a modern legal principle" and that the Ford case is "bad law"); Judy F. Sneirson, *Green is Good: Sustainability, Profitability, and a New Paradigm for Corporate Governance*, 94 IOWA L. REV. 987, 1003 (2009) (cases establishing a duty of shareholder wealth maximization are "few and far between and relatively obscure"); Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637, 651 (2006) ("Although *Dodge v. Ford* is frequently cited, no modern court has struck down an operational decision on the grounds that it favors stakeholder interests over shareholder interests"); Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1423-4 (1993) ("the mainstream of corporate law remains committed to the principles espoused by the Dodge court"); and Kent Greenfield, THE FAILURE OF CORPORATE LAW: FUNDAMENTAL FLAWS AND PROGRESSIVE POSSIBILITIES 41-42 (2006) ("there is no principle of corporate law that is more central to the way businesses are organized and regulated within the United States" than that of shareholder wealth maximization).

with the care that a reasonably prudent person would use, and (3) with the reasonable belief that they are acting in the best interests of the corporation."[45] This doctrine grants corporate directors significant leeway to make decisions that advance social objectives. However, this freedom is not unlimited, as the Business Judgment Rule will not protect any actions that are considered wasteful or irrational.[46]

By 1983, states began to enact corporate constituency statutes to give directors some ability to consider interests other than those of the shareholders.[47] Not all states have adopted constituency statutes, and some provide directors with more latitude than others.[48] While many of the constituency statutes allow directors to consider the interests of employees, creditors and customers, most do not allow directors to consider broader environmental issues or human rights concerns.[49] As will be described more fully in Part II, some states' Benefit Corporation laws allow directors to consider the interests of a very broad array of stakeholders, thus providing an advantage over constituency statutes.

B. *The Social Entrepreneurs Shape the Hybrid Entity*

Social enterprise is the application of private business models to remedy social needs or ills.[50] The actions of the social enterprise movement are not dictated by a pre-determined set of purposes or activities, but rather social entrepreneurs seek to remedy social needs that they have identified.[51] There was increased recognition that the

[45] *Business Judgment Rule*, LEGAL INFORMATION INSTITUTE, http://www.law.cornell.edu/wex/business_judgment_rule (last visited Mar. 30, 2014).

[46] Steve Munch, *Improving the Benefit Corporation: Traditional Governance Mechanisms Can Enhance the Innovative New Business Form,* 7 NW.J.L. & SOC.POL'Y 170, 179 (2012).

[47] 15 PA. CONS. STAT. § 515-517 (1990).

[48] *See*, Jonathan Springer, *Corporate Law Corporate Constituency Statutes: Hollow Hopes and False Fears*, 1999 ANN. SURV. AM. L. 85 (1999) (for a more detailed discussion of constituency statutes).

[49] *Id.*

[50] Alicia E. Plerhoples, *Can an Old Dog Learn New Tricks? Applying Traditional Corporate Law Principles to New Social Enterprise Legislation*, 13 TRANSACTIONS: TENN. J. BUS. L. 221, 230 (2012).

[51] *Id.* at 231.

government alone could not solve social problems.[52] Unconstrained by bureaucracy, politics, and set budgets, and having access to private resources, social entrepreneurs possess distinct advantages over government agencies when it comes to exploring and solving social ills.[53] These entrepreneurs "have an important role to play, whether it is to complement or supplant government efforts."[54]

The early encouragement of social entrepreneurs can be traced back to the efforts of three innovative, nonprofit organizations in the 1980's: Ashoka, New Ventures, and the Alpha Center for Public and Private Initiatives.[55] Ashoka, a global organization founded by Bill Drayton in 1980, was created to promote social change by investing in social entrepreneurs and presently "engages communities of entrepreneurs and develops patterns of effective collaborations that change entire fields."[56] In that same year, New Ventures was founded by Ed Skloot as a consulting firm with the goal of helping nonprofit organizations to discover new sources of funding.[57] This mission soon advanced to also helping the nonprofits develop business skills that could enhance their financial viability.[58] A few years later, in 1985, the Alpha Center for Public and Private Initiatives was founded to encourage entrepreneurs to address social problems.[59] Most significantly, the Alpha Center "brought into the conversation this idea of blurring the sector boundaries. And it raised the question of what can and should be done by nonprofits and what role for-profit or hybrid structures might play in achieving sustainable social impact."[60]

[52] J. Gregory Dees, *Taking Social Entrepreneurship Seriously*, 44 SOCIETY 24, 25 (2007).

[53] *Id.* at 26.

[54] *Id.* at 27.

[55] Katherine Fulton & Greg Dees, *The Past, Present, and Future of Social Entrepreneurship, a Conversation with Greg Dees*, DUKE UNIV. CENTER FOR ADVANCEMENT OF SOCIAL ENTREPRENEURSHIP (Feb. 15, 2006), http://www.caseatduke.org/documents/deesinterview.pdf [hereinafter *Past, Present and Future*].

[56] *Ashoka Approach*, ASHOKA, https://www.ashoka.org/approach (last visited Mar. 30, 2014).

[57] Fulton & Dees, *supra* note 55.

[58] *Id.*

[59] *Id.*

[60] Fulton & Dees, *supra* note 55.

"[T]hrough a process of exploration, innovation, experimentation, and resource mobilization," these entrepreneurs unearthed and generated new opportunities.[61] Increasingly, for-profit business owners began to consider ways in which their corporations might somehow serve the common good. Brands such as Ben & Jerry's, Seventh Generation, and Newman's Own, introduced the notion of the social responsibility of business to consumers.[62] Ben & Jerry's introduced the improvement of the environment as a "second bottom line" for business.[63] For this reason, it is sometimes considered to be the first socially responsible business.[64] The stated social mission of Ben & Jerry's is to initiate innovative ways to improve the quality of life nationally and internationally.[65] All the after-tax profits of Newman's Own are donated to charities both in the United States and abroad.[66] Since the formation of the company in 1982, the company has donated over $400 million.[67]

Soon, a third "bottom line" was added to the socially responsible business agenda with a focus on people— not just employees and consumers, but the environment as well.[68] Seventh Generation, for example, with its commitment to considering the effects of its actions on the next seven generations, designs products with sustainability in mind and has helped to create benchmarks for sustainable corporate behavior, which resulted in the company being named a 2011 Leader for Change by the United Nations and the Foundation for Social Change.[69] This "triple bottom line" also referred to as "Corporate

---

[61] Dees, *supra* note 52.

[62] Alissa Mickels, 32 HASTINGS INT'L & COMP. L. REV. 271, 274 (2009).

[63] Frank J. Cavico & Bahaudin G. Mutjaba, *National and Global Perspectives of Corporate Social Responsibility*, INT'L J. MGMT. SCI. & BUS. RES. 1, 7 (2012), *available at* http://ijmsbr.com/National-5.pdf; *see also* Jeffrey Hollender & Stephen Fenichell, WHAT MATTERS MOST: HOW A SMALL GROUP OF PIONEERS IS TEACHING SOCIAL RESPONSIBILITY TO BIG BUSINESS, AND WHY BIG BUSINESS IS LISTENING 167-69 (2004).

[64] Cavico & Mutjaba, *supra* note 63 at 7.

[65] BEN AND JERRY'S, "Our Values," http://www.benjerry.com/values (last visited May 13, 2014).

[66] NEWMAN'S OWN, "Charities," http://www.newmansown.com/charity/ (last visited May 13, 2014).

[67] *Id.*

[68] Mickels, *supra* note 62.

[69] Press Release, Reuters: Seventh Generation Named 2011 United Nations Leader of Change (October 19, 2011), http://www.reuters.com/article/2011/10/19/idUS231603+19-Oct-

Social Responsibility," "Creative Capitalism," and "Venture Philanthropy" soon gained traction.

The start of the twenty-first century has brought a marked increase in interest in and development of social entrepreneurship.[70] Data available from Bloomberg shows that by 2007 "about 11 [percent] of all assets under professional management (more than 2.7 trillion) were invested in a socially responsible investment and more than 30,000 U.S. companies were members of socially responsible business organizations."[71] In 2009, the White House Office of Social Innovation was created to increase investment in social enterprises.[72] In fact, the notion of corporate social responsibility had become so accepted by the start of the twenty-first century, that, in 2011, for the first time in its 94-year history, Forbes magazine released a ranking list based on social innovation.[73] The Forbes Impact 30 ranking recognizes the top 30 social innovators judged on impact, social accountability, and social entrepreneurship.[74] With growing widespread recognition of social entrepreneurship, it is not surprising that the next step along the journey was the creation of an entity that could still maintain a certain level of profit, yet also have a nonprofit purpose. This was the L3C, the low profit, limited liability company.

1. The L3C is Created to Secure Program Related Investments

One of the earliest steps to creating a type of hybrid entity that could derive profit and also carry out a nonprofit purpose can be traced back to the work of the Aspen Institute. The Aspen Institute, established in 1950, is a widely recognized, international nonprofit organization working "to foster leadership based on enduring values

2011+MW20111019.

[70] John Tozzi, *New Legal Protections for Social Entrepreneurs*, BLOOMBERG BUSINESS WEEK, Apr. 22, 2010, *available at* http://www.businessweek.com/smallbiz/content/apr2010/sb20100421_414362.htm.

[71] *Id.*

[72] Steven Haymore, *Public(ly Oriented) Companies: B Corporations and the Delaware Stockholder Provision Dilemma*, 64 VAND. L. REV. 1311 (2011).

[73] Helen Coster, *Forbes List of the Top Thirty Social Entrepreneurs*, FORBES (Nov. 30, 2011), http://www.forbes.com/sites/helencoster/2011/11/30/forbes-list-of-the-top-30-social-entrepreneurs/.

[74] *Id.*

and to provide a nonpartisan venue for dealing with critical issues."[75] As part of its mission, the Institute hosts regular seminars and policy programs bringing together some of the leading figures in the social enterprise movement for discussion and problem-solving.[76] At one such meeting in September of 2006 entitled, "Exploring New Legal Forms and Tax Structures for Social Enterprise Organizations," one of the participants, Robert Lang, proposed a plan for a low-profit, limited liability company ("L3C") that would advance a social mission and at the same time provide a vehicle to receive investments from private investors, the government, and nonprofit foundations.[77] This last item, securing funding from private foundations, referred to as Program Related Investments or PRIs, was one of Lang's primary motivators in creating the L3C.[78]

The law governing private foundations requires foundations to spend a certain percentage of their funds each year on charitable purposes.[79] Failure to distribute 5 percent of income (whether through grants, donations, or PRIs) results in the imposition of an excise tax.[80] Excise taxes are also imposed when a private foundation makes investments that may jeopardize the fulfillment of their exempt purpose.[81] According to Treasury Regulations,

> an investment shall be considered to jeopardize the carrying out ofthe exempt purposes of a private foundation if it is determined that the foundation managers, in making such investment, have failed to exercise ordinary business

---

75 Harvard University Institute of Politics, Aspen Institute, http://www.iop.harvard.edu/aspen-institute; *The Aspen Institute Mission Statement*, ASPEN INSTITUTE, http://www.aspeninstitute.org/about (last visited August 17, 2013).

76 *The Aspen Institute Mission Statement*, ASPEN INSTITUTE, http://www.aspeninstitute.org/about (last visited August 17, 2013).

77 Thomas J. Billitteri, *Mixing Mission and Business: Does Social Enterprise Need a New Legal Approach, Highlights from an Aspen Institute Roundtable*, ASPEN INST. (Jan. 2007), http://tidescanada.org/wp-content/uploads/files/causeway/Mixing_Mission_and_Business.pdf.

78 *Id.*

79 I.R.C. § 4942 (2014).

80 Matthew Doeringer, *Fostering Social Enterprise: A Historical and International Analysis*, 20 DUKE J. COMP. & INT'L L. 291 (2010). Section 4942 of the Internal Revenue Code imposes an excise tax of 30% of the amount of income that is undistributed at the beginning of the subsequent tax year. This amount will increase to 100% if distribution requirements are not met in a specified period.

81 I.R.C. § 4944 (2014).

> care and prudence, under the facts and circumstances prevailing at the time of making the investment, in providing for the long- and short-term financial needs of the foundation to carry out its exempt purposes. In the exercise of the requisite standard of care and prudence the foundation managers may take into account the expected return (including both income and appreciation of capital), the risks of rising and falling price levels, and the need for diversification within the investment portfolio (for example, with respect to type of security, type of industry, maturity of company, degree of risk[,] and potential for return).[82]

There is an exception to the imposition of excise taxes on jeopardizing investments if the investment is a PRI.[83] To be considered a PRI: (1) the primary purpose of the investment must be to accomplish a charitable or educational purpose as described in Internal Revenue Code section 170(c)(2)(B); (2) the production of income or capital appreciation of property cannot be a significant portion of the investment; and (3) the investment cannot be used for political or legislative purposes described in Internal Revenue Code section 170(c)(2)(D).[84] Under these rules, a private foundation's investments in the form of loans, grants, and equity purchases in socially-motivated for-profit entities could qualify as a PRI.[85] Richard Lang structured the L3C so that it would be able to meet the PRI requirements, thereby encouraging investment by the nonprofit sector in the for-profit LLC.[86]

a. The Number of States Recognizing L3Cs Continues to Grow

Working with Richard Lang, Americans for Community Development ("ACD") has been responsible for promoting the state adoption of the L3C form of business.[87] Lang and the ACD achieved a

---

82 Treas. Reg. § 53.4944-1(a)(2)(i) (2014).

83 I.R.C. § 4944(c) (2014).

84 *Id.*

85 Deborah Andrews, *The "L3C": The New Double-Hybrid Entity*, PHILANTHROPY J., (Dec. 10, 2010), http://www.philanthropyjournal.org/resources/managementleadership/%E2%80%98l3c%E2%80%99-new-double-hybrid-entity.

86 Billitteri, *supra* note 77 at 13-14.

87 Americans for Community Development,

measure of success when Vermont became the first state to recognize the L3C as a legal entity in April, 2008.[88] Since that time, 215 active L3Cs have organized in Vermont.[89] In addition to Vermont, eight other states have adopted the L3C: Illinois, Louisiana, Maine, Michigan, North Carolina, Rhode Island, Utah, and Wyoming.[90]

L3C legislation is currently pending in several other states.[91] Two federal jurisdictions— the Oglala Sioux Tribe and the Crow Indian Nation of Montana— have also adopted L3C legislation.[92] This legislation allows "a limited liability company . . . to become a low-profit limited liability company . . . when organized for a business purpose and operated to significantly further charitable purposes but without a significant purpose to produce income or asset appreciation."[93]

b. The Flexible Nature of the L3C makes it an Appealing Investment Vehicle

The statutory requirements of the Vermont L3C are substantially the same as those adopted in the other states. The L3C may be organized for any purpose, but must be operated to satisfy the

http://www.americansforcommunitydevelopment.org/ (last visited Apr. 8, 2014).

88 VT. STAT. ANN. tit. 21, § 3001(27) (2012).

89 *Here's the Latest L3C Tally*, INTERSECTOR PARTNERS L3C (Mar. 3, 2014), http://www.intersectorl3c.com/l3c_tally.html (The tally of active L3Cs in the other states are: 147 in Illinois, 170 in Louisiana, 339 in Maine, 218 in Michigan, 105* in North Carolina, 7 in Rhode Island, 57 in Utah, and 41 in Wyoming. *L3C law repealed as of January 1, 2014).

90 805 ILL. COMP. STAT. 180/1-26 (2012); L.A. REV. STAT. ANN. § 12:1305 (2012); ME. REV. STAT. tit. 31, § 1611 (2012); MICH. COMP. LAWS § 450.4102 (2012); N.C. GEN. STAT. § 57C-2-01(d) (2012) (repealed 2014); R.I. GEN. LAWS § 7-16-2 (2012); UTAH CODE ANN. § 48-2c-102(4)(b) (2012); WYO. STAT. ANN. § 17-29-102(ix) (2012).

91 *See* S.B. 323, Reg. Sess. (Cal. 2011); S.B. 528, Gen. Assemb. (Conn. 2013); H.B. 2361, Reg. Sess. (KS. 2013); H.B. 167, 188th Gen. Ct. (Mass. 2013); H.B. 606, Reg. Sess. (Mo. 2013); A.B. 6005, Gen. Assemb., (N.Y. 2013); S.B. 1825, Gen. Assemb. (N.Y. 2013); S.B. 5097, Gen. Assemb. (N.Y. 2013); S.B. 506, 108th Reg. Sess. (Tenn. 2013); H.B. 2622, 83rd Leg. (Tex. 2013); A.B. 870 (Wis. 2013); Carter G. Bishop, *Fifty State Series: L3C and B Corporation Legislation Table* (SUFFOLK UNIV. LAW SCH., LEGAL STUDIES RESEARCH PAPER SERIES, RESEARCH PAPER 10-11, April 1, 2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1561783.

92 *Laws*, AM. FOR CMTY. DEV.: THE ORG. FOR THE L3C, http://www.americansforcommunitydevelopment.org/legislation.html (last visited Dec. 5, 2013).

93 Carter G. Bishop, *The Low-Profit LLC (L3C): Program Related Investment by Proxy or Perversion?*, 63 ARK. L. REV. 243, 243 (2010).

following:

> (A) The Company significantly furthers the accomplishment of one or more charitable or educational purposes within the meaning of Section 170(c)(2)(B) of the IRS Code of 1986 . . . and (ii) would not have been formed but for the company's relationship to the accomplishment of charitable[94] or educational purposes.
>
> (B) No significant purpose of the company is the production of income or the appreciation of property; provided, however, that the fact that a person produces significant income or capital appreciation shall not, in the absence of other factors, be conclusive evidence of a significant purpose involving the production of income or the appreciation of property.
>
> (C) No purpose of the company is to accomplish one or more political or legislative purposes within the meaning of Section 170(c)(2)(D) of the IRS code of 1986 . . . [and]
>
> (D) If a company that met the definition of this subdivision . . . at its formation at any time ceases to satisfy any one of the requirements, it shall immediately cease to be a low-profit LLC, but by continuing to meet all the other requirements of this chapter, will continue to exist as a limited liability company.[95]

This language mirrors that of the PRI requirements. While the L3C can earn a profit, this can only be incidental and not a significant purpose of the entity. The L3C statutory language was drafted with the intention of having the L3C qualify as a PRI for private foundations to help facilitate this funding.[96] All states require that some variation of L3C or low-profit LLC be included in the entity name.[97] As a general rule, state laws also include ramifications in the

[94] Charitable and education purposes include "religious, charitable, scientific, literary, or educational purposes . . . foster[ing] national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), . . . [and] prevent[ing] . . . cruelty to children or animals." I.R.C. § 170(c)(2)(B) (2012).

[95] VT. STAT. ANN. tit. 11, § 3001(27) (2013).

[96] For an excellent discussion of the L3C as a qualified Program Related Investment, see generally Bishop, *supra* note 93.

[97] CHRISTOPHER REINHART, NO. 2011-R-0344, OLR RESEARCH REPORT: LOW-PROFIT LIMITED LIABILITY COMPANIES OR L3CS (2011), http://www.cga.ct.gov/2011/rpt/2011-R-0344.htm.

event the entity no longer qualifies as an L3C.

The L3C provides all the benefits of an LLC, such as a flexible ownership structure, profit distributions, and flow-through taxation.[98] The L3C provides "both that credibility and liability protection for the owners and management, while leaving enforcement to the state and not subjecting the business to periodic audits by a third party. Plus, great branding and marketing opportunities."[99] Some areas where L3Cs have been utilized include: carbon trading, alternative energy, food bank processing, social services, arts funding, job creation programs, and housing for low income and aging populations.[100] In Maine, this hybrid form of business seemingly saved a group of Maine dairy farmers. When Maine dairy farmer David Vaughn lost his contract with his organic milk processor, H.P. Hood, he and nine other small farmers also let go by Hood, joined together to create an L3C, MOOMilk, to process and sell their milk on their own.[101] By doing business in this form, they hope to gain funding from both social funds and foundations.[102] According to attorney Paul Dillon, who structured the business, the L3C made sense for the farmers.[103] He stated, "[i]nstead of building equity for the middle guy, we're using the low-profit model to keep profits going to the farmers . . . . Nobody's going to get rich investing in this L3C. But, if the goal is to save family farms, that is going to happen."[104]

Given the short life of this entity, the legal and tax consequences of this form of doing business remain to be seen. At present, no special tax incentives exist for this form of business.[105] This is not

[98] *See* Billitteri, *supra* note 77, at 6-7, 13.

[99] Jessica Manganello, *The Low Profit Limited Liability Company (L3C): A New Model for Cleantech?*, GREEN LIGHT DISTRIKT (Sept. 13, 2010), http://thegreenlightdistrikt.com/2010/09/13/the-low-profit-limited-liability-company-l3c-a-new-model-for-cleantech.

[100] Jim Witkin, *The L3C: A More Creative Capitalism*, TRIPLEPUNDIT (Jan. 15, 2009), www.triplepundit.com/2009/01/the-l3c-a-more-creative-capitalism.

[101] Malika Zouhali-Worrall, *For L3C Companies, Profit Isn't the Point*, CNNMONEY (Feb. 9, 2010 10:49 AM), http://money.cnn.com/2010/02/08/smallbusiness/l3c_low_profit_companies/#.

[102] *Id.*

[103] *Id.*

[104] *Id.*

[105] Evangeline Gomez, *The Rise of the Charitable For-Profit Entity,* FORBES (Jan. 31, 2012), http://www.forbes.com/sites/evangelinegomez/2012/01/13/the-rise-of-the-charitable-for-profit-entity/.

surprising, since most L3Cs, as other LLCs, are not taxed at the entity level unless they opt for such tax treatment.[106] If the entity has a single owner, it will automatically be treated as a flow-through. However, if there are multiple owners or members the entity can elect to be taxed as a corporation, but if such election is not made, the entity will not itself be subject to tax.[107]

To date, the level of PRI funding anticipated by the founders of the L3C movement has not been realized.[108] The most significant reasons for this are likely that (1) foundations tend to refrain from making PRIs due to the costs of ensuring compliance with the private foundation rules governing PRIs and (2) the L3C is a new form of business with an unproven track record.[109] Concern has been expressed that the language of the L3C legislation incorrectly implies that the structure of the entity will simplify access to PRIs, which is not the case.[110]

Foundations would want certainty that the L3C qualifies as a PRI in order to avoid making a "jeopardizing investment." However, "[i]t is cumbersome and costly to determine what qualifies as a PRI, since foundations have yet to use PRIs on a large scale."[111] Absent an official IRS announcement that investment in an L3C can qualify as a PRI, foundations are likely to hesitate to invest in this manner.[112] To address such concerns, Congressmen Jared Polis (D-Colorado) and

[106] Treas. Reg. § 301.7701-3(b)(1) (2014) (An LLC with a single member (owner) is considered a disregarded entity for tax purposes; an LLC with multiple members is automatically taxed as a partnership unless taxation as a corporation is elected).

[107] Treas. Reg § 301.7701-3 (2014) ("Check-the-box regulations").

[108] Elizabeth Schmidt, *Vermont's Social Hybrid Pioneers: Early Observations and Questions to Ponder*, 35 VT. L. REV. 163, 189-90 (2010).

[109] *Id.* at 190-91.

[110] Daniel Kleinberger, *ABA Business Law Section, on Behalf of its Committees on LLCs and Nonprofit Organizations, Opposes Legislation for Low Profit Limited Liability Companies (L3Cs)* (William Mitchell Coll. of Law, Working Paper No. 2012-05, 2012). (There are no shortcuts with regard to compliance for PRIs. Private foundations would risk their tax exempt status if they did not ensure that the PRI furthered the foundation's mission and that foundation funds were not improperly being used for a private benefit. Since for-profit investors will likely expect a market rate of return, and the nonprofit investors will receive a lower rate of return, there is concern whether nonprofit funding would be put to a private use).

[111] Heather Sertial, Hybrid Entities: *Distributing Profits with a Purpose*, 17 FORDHAM J. CORP. & FIN. L. 261, 283 (2012).

[112] *Id.*

Aaron Schock (R-Illinois) introduced H.R. 3420, the Philanthropic Facilitation Act of 2011, to Congress in November of 2011 to "simplify the ability of foundations to invest in businesses with common missions."[113] This bill is not designed to change the criteria as to what qualifies as a PRI but rather to simplify the process by which a business can receive approval from the IRS that it qualifies as a PRI, a factor that might make the L3C investments more attractive to private foundations. This legislation did not pass, but similar legislation, H.R. 2832, was reintroduced in July 2013 by Congressman Cory Gardner (R-Colorado) and co-sponsored by Congressman Polis.[114]

In April 2012, proposed Treasury Regulations were released to supplement the existing forty-year-old regulations defining PRIs.[115] These regulations have been proposed because "[t]he Treasury Department and the IRS are aware that the private foundation community would find it helpful if the regulations could include additional PRI examples that reflect current investment practices."[116] The new examples make it clear that PRIs can include equity investments and loans to for-profit organizations that serve as a vehicle for accomplishing an exempt purpose. For instance, proposed example 11 describes a private foundation's purchase of stock of a for-profit subsidiary of a for-profit drug company.[117] The subsidiary was formed to research and develop a vaccine to prevent a disease that predominantly affects poor people living in developing countries.[118] The subsidiary will also distribute the vaccine at an affordable price. According to the proposed regulations, this investment qualifies as an investment in a PRI because the purpose of advancement of science furthers the foundation's exempt activities.[119]

This example is similar to the $10 million investment of the Bill & Melinda Gates Foundation in Liquidia, a biotechnology company

[113] Karl Dakin, *Congressman Polis Introduces Philanthropic Facilitation Act of 2011*, SULLIVAN CHAIR (Nov. 22, 2011), http://sullivanchair.com/congressman-polis-introduces-philanthropic-facilitation-act-of-2011/.

[114] Philanthropic Facilitation Act, H.R. 2832, 113th Cong. (2013), *available at* http://thomas.loc.gov/cgi-bin/query/z?c113:H.R.2832.IH:.

[115] Prop. Treas. Reg. § 53.4944-3, 77 Fed. Reg. 23429 (Apr. 19, 2012).

[116] *E.g.,* Prop. Treas. Reg. § 53.4944-3, 77 Fed. Reg. 23429, 23429 (Apr. 19, 2012).

[117] *Id.* at 23, 430.

[118] *Id.*

[119] *Id.*

involved with vaccine development.[120] It is recognized that "interest is growing rapidly in using PRIs to buy stakes in businesses that can help foundations achieve their missions . . . and the Gates Foundation alone will change the dynamics."[121] The proposed regulations do not provide any specific guidance on the investment in an L3C, but the fact that they clarify that investment in a for-profit entity is permissible, and that a broad array of activities can be supported (such as advancing science, promoting the arts, and addressing environmental concerns) may make private foundations more willing to invest in this relatively new form of business.[122] Updates to the proposed regulations are expected, as indicated by the following comments issued by the White House, encouraging feedback, "[w]e hope that the proposed rule will spark a dialogue over the next few months with the philanthropic community. Through feedback on the guidelines and an exchange of ideas, we hope to update the regulations in a manner that serves the public interest."[123]

While the L3C is admittedly a flexible hybrid form that may expand the funding of for-profit social enterprise, some argue that the L3C is an unnecessary form of business in that it adds nothing new to existing law.[124] For example, in Delaware, as in many other states, an LLC can be organized for any purpose and can choose to both provide societal benefits and produce profits; no special designation is required since the "freedom to contract" permits operating agreements to be drafted as the parties see fit.[125] Further supporting this view is a private letter ruling in which the Internal

---

[120] Stephanie Strom, *To Advance Their Cause, Foundations Buy Stocks*, N.Y. TIMES, Nov. 25, 2011, at B1, *available at* http://www.nytimes.com/2011/11/25/business/foundations-come-to-the-aid-of-companies.html?pagewanted=all.

[121] *Id.*

[122] *E.g.*, Prop. Treas. Reg. § 53.4944-3, 77 Fed. Reg. 23429, 23429, 23430 (Apr. 19, 2012).

[123] Jonathan Greenblatt, *Opening the Door for Program Related Investments*, WHITE HOUSE OFF. SOC. INNOVATION & CIVIC PARTICIPATION (May 4, 2012), http://www.whitehouse.gov/blog/2012/05/04/opening-door-program-related-investments.

[124] For an in-depth critique of the L3C, see Ann E. Conaway, *The Global Use of the Delaware Limited Liability Company for Socially-Driven Purposes*, 38 WM. MITCHELL L. REV. 772 (2012).

[125] *Id.* at 784.

Revenue Service approved a foundation's investment in a for-profit LLC as a PRI because the operating agreement of the entity matched the foundation's mission objectives.[126] Such a ruling reinforces the position taken by the Business Law section of the American Bar Association which came out in opposition to the passage of L3C legislation when such legislation was proposed in Minnesota.[127]

The ABA committee views the L3C as an unnecessary form of business since under Minnesota's existing LLC statute, "it is already possible to create a low-profit limited liability company."[128] The Minnesota LLC statute, much like the LLC statutes of majority of states, allows the members of the LLC to determine the LLC's purpose and allocation of rights.[129] The ABA committee is not alone in its concerns. In fact, the existence of the L3C in North Carolina has been such a source of controversy that effective January 1, 2014, the low-profit LLC will be dropped from the state's LLC statute.[130]

The next logical step for the social enterprise movement was the creation of a hybrid *corporate* form of doing business: enter the Benefit Corporation.

III. BENEFIT CORPORATIONS ARE HERALDED AS THE IDEAL CORPORATE FORM FOR SOCIALLY RESPONSIBLE ENTREPRENEURS

According to a White Paper on the need and rationale for the Benefit Corporation, "[f]or-profit entrepreneurship, social investing, and the sustainable business movement have reached critical mass. . . . [A]ccelerating consumer and investor demand has resulted in the formation of a substantial marketplace for companies that put purpose, not profit, at the center of the business."[131] Responding to

---

[126] I.R.S. Priv. Ltr. Rul. 2006-10-020, at 1-3, 18 (Mar. 10, 2006).

[127] Kleinberger, *supra* note 110.

[128] *Id.*

[129] *Id.*

[130] Doug Batey, *North Carolina Becomes the First State to Drop L3C's*, LLC LAW MONITOR (July 9, 2013 12:02 PM) http://www.llclawmonitor.com/2013/07/articles/lowprofit-llcs/north-carolina-becomes-the-first-state-to-drop-l3cs/.

[131] William H. Clark & Larry Vranka, *The Need and Rationale for the Benefit Corporation: Why It Is the Legal Form that Best Addresses the Needs of Social Entrepreneurs, Investors, and, Ultimately, the Public*, BENEFIT CORP., Apr. 2012, http://benefitcorp.net/storage/The_Need_and_Rationale_for_Benefit_Corporation

the call for an increased emphasis on stakeholders in corporate decision making, in April, 2010, Maryland became the first state to enact Benefit Corporation legislation.[132] Since then, several other states have followed suit.[133] Benefit Corporations are formed to have a "material, positive impact on society and the environment."[134] Language in the corporate charter requires directors to consider the interests of a broad variety of stakeholders, including, but not limited to, the community, employees, and consumers.[135] Benefit Corporation shareholders "now have additional rights to hold directors accountable for failure to create a material positive impact on society or to consider the impact of decisions on employees, community, and the [local and global] environment."[136] In addition to having a general positive impact on society, the Benefit Corporation may also choose to provide specific public benefits such as preserving the environment, improving human health, promoting the arts, sciences, and advancement of knowledge.[137] Whether or not the Benefit Corporation meets its obligations and has a positive impact on society may be determined with reference to an independent, third party standard.[138] Most Benefit Corporations are required to report annually on their social and environmental performance using this standard.

Several prominent social-minded businesses have welcomed the new form of business and modified their corporate charters to adopt this form. For example, shortly after Vermont enacted Benefit Corporation legislation in July 2011, King Arthur Flour Corporation became one of the first businesses in the state to become a Benefit

s_-_April_2012.pdf.

[132] Michael Deskins, *Benefit Corporation Legislation: Version 1.0 — A Breakthrough in Stakeholder Rights?*, 15 LEWIS & CLARK L. REV 1047 (2011).

[133] *See supra* note 8.

[134] Dana Brakman Reiser, *Benefit Corporations: A Sustainable Form of Organization?*, 46 WAKE FOREST L. REV. 591, 597 (2011) (quoting S.B. 298, 2011 Leg., 26th Sess. §§ 2, 5 (Haw. 2011)).

[135] MD CODE ANN. CORPS & ASS'NS, § 5-6C-07 (West 2012). Existing corporations can convert to Benefit Corporation status as long as two-thirds of the shareholders approve the necessary amendments to the corporate charter. MD CODE ANN. CORPS & ASS'NS, § 5-6C-03(b) (West 2012); see also MD CODE ANN. CORPS & ASS'NS, § 2-604(e) (West 2012).

[136] Press Release, *supra* note 6.

[137] Reiser, *supra* note 134 at 597-98.

[138] Munch, *supra* note 46 at 186.

Corporation. Becoming a Benefit Corporation was a logical step for this 200-plus year old employee-owned corporation that prides itself on its commitment to the community, to its employees, and to the environment.[139] In recognition of these efforts, it has received accolades such as a Social Legacy Award "for handing down to employee owners a centuries-old tradition of purity, for both the consumer and the environment."[140] According to a King Arthur Flour spokesperson, "even in becoming . . . a Vermont Benefit Corporation, it wasn't a significant change for employees, because we were already operating in this socially responsible way. It just codified that commitment."[141]

Having a third party conduct an annual evaluation has been touted as an important component of Benefit Corporation status. Responding to increased consumer demand for socially responsible products, product marketing terms such as "green" and "sustainable" are now so widely used that they have begun to lose their meaning.[142] To combat this problem, known as "greenwashing," a variety of organizations, among them Greenseal, Underwriters Laboratories, Global Reporting Initiative, Green American, and B-Lab, provide performance evaluations and certifications such as "Organic," "Free Trade," "Energy Star," and "Greenseal."[143] One of the challenges this presents is how this standard will be set and applied. The model legislation does not specify what form the standards will take, nor does it dictate how compliance will be monitored; all that is required is independence and transparency in the process.[144] As will be discussed later in this paper, the requirement of third party assessment has not, in fact, been included in all state Benefit Corporation statutes.

---

139 *Id.* at 172.

140 Peter Asmus, *16th Annual Business Ethics Awards*, BUSINESS ETHICS, Fall 2004, at 8, 15, *available at* http://secure.pdcnet.org/852575A9004F1216/file/B95146B60F5C3DBC852576850063DFD5/$FILE/bemag_2004_0018_0003_0006_0015.pdf.

141 Jeff Gangemi, *King Arthur Flour: A Sustainability-Minded Corporation Expands Its Footprint* (May 2, 2012), http://www.farmplate.com/category/blog-tags/local-food.

142 William H. Clark & Elizabeth Babson, *How Benefit Corporations Are Redefining the Purpose of Business Corporations*, 38 WM. MITCHELL L. REV. 817, 820–21 (2012).

143 *Id.* at 821; Briana Cummings, Note, *Benefit Corporations: How to Enforce a Mandate to Promote the Public Interest*, 112 COLUM. L. REV. 578, 594 (2012).

144 Reiser, *supra* note 134.

A. *The Benefit Corporation Model Charter is Created by B-Lab*

One entity available to provide an independent, third party review of Benefit Corporations is B-Lab, a Pennsylvania nonprofit with a direct connection to the Benefit Corporation movement.[145] B-Lab was formed in 2006 by three friends, Andrew Kassoy, Jay Coen Gilbert, and Bart Houlahan, who recognized at that time that, "there is a huge marketplace of companies and their consumers and investors . . . are interested in creating value for all stakeholders, not just shareholders."[146] B-Lab proposed the idea of a Certified B Corporation that would be certified by B-Lab.[147] A Certified B Corporation is a corporation that creates a general public benefit as measured by an independent third-party standard.[148]

Unlike the Benefit Corporation, the Certified B Corporation does not represent a new corporate structure; rather, it is a for-profit entity given a social enterprise seal of approval by the B-Lab.[149] A Certified B Corporation must meet a minimum set of social and environmental performance standards and also submit to periodic audits.[150] To become certified as B Corporation an entity must (1) earn a minimum score of 80 on the B Impact Assessment,[151] (2) adopt the B Corporation Legal Framework, and (3) sign a Term Sheet and Declaration of Interdependence to make the certification official.[152]

145 *The B Corporation: A Business Model for the New Economy*, CAP. INST., http://capitalinstitute.org/metrics/b-corporation-business-model-new-economy (last visited March 28, 2014).

146 *Id.*

147 *Id.*

148 *Id.*

149 *Id.*

150 *Id.*

151 This is a benchmark tool for social and environmental impact. *See* B LAB, Performance Requirements, http://www.bcorporation.net/become-a-b-corp/how-to-become-a-b-corp/performance-requirements (last visited May 8, 2014). According to the company's website, "B-Lab's Standard Advisory Council, an independent committee, is responsible for the content and weighting of the standards expressed in the B Impact Assessment. Each member of the SAC is respected for their wisdom and their deep industry or stakeholder expertise." *See also* B IMPACT ASSESSMENT, Standards Advisory Council, http://bimpactassessment.net/our-team (last visited May 8. 2014).

152 B LAB, Term Sheet for Certified B Corporations (2013), http://www.bcorporation.net/sites/default/files/documents/term_sheets/2013_Non_constituency_non_benefit.pdf (last visited May 15, 2014). This legal framework clarifies the pursuit of the dual mission of social benefit for stakeholder and profit.

Once certified, 20 percent of B Corporations are randomly selected for an on-site review during every two-year term.[153]

To date, there are over 600 Certified B Corporations generating revenue of $3.11 billion annually and doing business in over 60 industries.[154] One of the stated goals of B-Lab has been to effect a broader change in the marketplace and move toward a system in which entities like the Certified B Corporation would be accorded a legal form of their own.[155] To that end, B-Lab has been actively engaged in encouraging the adoption of Benefit Corporation legislation in the states.[156] The following summary of the Model Benefit Corporation Legislation proposed by B-Lab is instructive in that it contains many of the provisions adopted in each of the states that have enacted Benefit Corporation legislation, although states are free to adopt their own variations of this model. There is no "one size fits all" Benefit Corporation.

Key provisions of the Term Sheet are: certification is for a two year period, B Corporations must submit an Impact Assessment; corporations must agree to an on site review, and corporations must comply with use of B Lab intellectual property. B LAB, Term Sheet for Certified B Corporations (2013), *available at*, http://www.bcorporation.net/sites/default/files/documents/term_sheets/2013_Non_constituency_non_benefit.pdf (last visited May 15, 2014). The Declaration of Interdependence recognizes the ability of private enterprise to produce a public benefit. B LAB, Term Sheet for Certified B Corporations (2013), *available at*, http://www.bcorporation.net/sites/default/files/documents/term_sheets/2013_Non_constituency_non_benefit.pdf (last visited May 15, 2014).

[153] B LAB, Term Sheet for Certified B Corporations (2013), http://www.bcorporation.net/sites/default/files/documents/term_sheets/2013_Non_constituency_non_benefit.pdf (last visited May 15, 2014).

[154] B CORPORATION, 2012 ANNUAL REPORT (2012) at 3, 8.

[155] BENEFIT CORP INFORMATION CENTER, http://benefitcorp.net/about-b-lab (last visited Apr. 1, 2014).

[156] *Id.*

Table 2: Highlights of Model Legislation[157]

Corporate Purposes
Create a general public benefit
Right to name a specific benefit for purpose
Creation of public benefit in best interest of the corporation
Accountability
Director's duty— make decisions in best interest of the corporation
Director's duty— consider effects on stakeholders
Independent Benefit Director to attest board acted in accordance with duties
Transparency
Annual benefit report published in accordance with third party standards
Annual Report delivered to shareholders, website, Secretary of State
Right of Action
Only shareholders and directors have a right of action
Right of action for violation of duty (purpose or standard of conduct)

B. An Increasing Number of States are Adopting the Benefit Corporation

Twenty-six states and the District of Columbia have already enacted Benefit Corporation legislation and legislation is pending in several others.[158] This section reviews the Benefit Corporation for three states: Maryland, Vermont, and California.

1. Maryland Becomes the First State to Adopt the Benefit Corporation

Speaking on the day that Benefit Corporations were signed into

[157] Model Benefit Corporation Legislation with Explanatory Comments, B LAB 10-12, 15, 20-22, 24, http://benefitcorp.net/storage/documents/Model_Benefit_Corporation_Legislation.doc (last visited May 29, 2014).
[158] *See supra* notes 8-9 and accompanying text.

law by Governor Martin O'Malley, the bill's co-sponsor, State Senator Jamie Raskin stated, "[t]his is a great moment in the evolution of commercial life in Maryland and America."[159] Speaking on the same day, B-Lab co-founder, Jay Coen Gilbert remarked:

> Today marks an inflection point in the evolution of capitalism. With public trust in business at an all-time low, this represents the first systemic response to the underlying problems that created the financial crisis— protecting companies from the pressures of short-termism while creating benefit for shareholders and society over the long-haul.[160]

As initially drafted, the Benefit Corporation legislation did not encompass Limited Liability Companies.[161] However, this was soon rectified when Maryland modified its statute and became the first state to enact the Benefit LLC.[162] In another update to Benefit Corporation rules, in May 2011, Maryland became the first state to add the requirement that the term "Benefit" be included in the corporate name.[163]

When making business decisions, directors of a Maryland Benefit Corporation must consider: (1) the stockholders, (2) employees of the Benefit Corporation as well as subsidiaries and suppliers of the benefit Corporation; (3) customers, (4) community and societal concerns, and (5) the local and global environment.[164]

The directors do not owe a duty to the beneficiaries of the corporation's purposes and, therefore, these beneficiaries lack standing to bring a claim against the directors.[165] While Maryland

[159] B Lab, *Maryland First State in the Union to Pass Benefit Corporation Legislation*, CSRWIRE, Apr. 14, 2010, http://www.csrwire.com/press_releases/29332-Maryland-First-State-in-Union-to-Pass-Benefit-Corporation-Legislation.

[160] *Id.*

[161] *Clean Currents First Benefit LLC in State of Maryland and Country*, CLEAN CURRENTS (June 1, 2011), http://web.archive.org/web/20110717172616/http://www.cleancurrents.com/index.php/newsroom/86-clean-currents-first-benefit-llc-in-state-of-maryland (The original webpage was not available. As such, this source was located on a web archive).

[162] *Id.*

[163] Reiser, *supra* note 134, at 594.

[164] MD. CODE ANN. CORPS & ASS'NS, § 5-6C-07 (West 2012).

[165] Penny J. Minna & Namha B. Corbin, *Benefit Corporation Law Could Spur Socially Responsible Business Boom*, DAILY RECORD 3 [MARYLAND], July 29, 2010, http://thedailyrecord.com/2010/07/29/benefit-corporation-law-could-spur-socially-

Benefit Corporations are required to disclose their stakeholder impact as per a third party standard, Maryland does not require a minimum level of impact nor does it require that all of the performance requirements that apply to B Corporations be met.[166] While the legislation does not provide details on what an acceptable third party standard is, it does require that the standard be transparent.[167]

In the first three months after the new legislation was passed, fifteen benefit corporations were formed in Maryland.[168] The Maryland State Department of Assessments and Taxation does not keep a record of the number of Benefit Corporations in the state. However, a recent survey indicated that there are 16 Benefit Corporations and 23 Benefit LLCs in Maryland.[169]

> There are no tax breaks or procurement incentives for benefit corporations in Maryland, but the classification offers a competitive advantage. 'If you are feeding back into your customers goodwill, social justice, making sure your employees have sustainable wages, people understand that and in turn will support you for it,' said Pennye Jones-Napier, a Maryland Benefit Corporation business owner.[170]

2. Vermont Follows Suit

Soon thereafter, Vermont followed Maryland's lead and adopted Benefit Corporation legislation that became effective on July 1, 2011.[171] As in Maryland, new corporations can be formed as Benefit

---

responsible-business-boom/.

166 *Maryland Creates New Category of Organizations: Mission-Based, For-Profit Benefit Corporations* (Apr. 26, 2010), http://web.archive.org/web/20111230160928/http://www.bcorporation.net/resources/bcorp/documents/ openminds042610maryland.pdf (The original webpage was not available. As such, this source was located on a web archive).

167 MD. CODE ANN. CORPS & ASS'NS, § 5-6C-01(E) (West 2012).

168 Danielle Douglas, *Benefit Corporations Sign Up*, WASH. POST 1, Jan. 24, 2011, at A11, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2011/01/23/AR2011012303556.html.

169 Megan Burkhart, Ana Castro, & Adrian Sanchez, *Maryland Benefit Corporations Act: The State of Social Enterprise in Maryland* SLIDESHARE 5 (Jan., 2013), http://www.slideshare.net/changematters/maryland-benefit-corporations-analysis-full-report.

170 Douglas, *supra* note 168.

171 VT. STAT. ANN. tit. 11A, § 21.01 (2012).

Corporations or existing corporations can convert to Benefit Corporation status as long as two-thirds of the shareholders approve.[172] At least one board member of the Vermont Benefit Corporation must be designated as a benefit director with the responsibility for the company's annual report of its social and environmental performance.[173] Compared to Maryland, Vermont provides more specific guidance regarding the rights of shareholders and how the actions of the directors can be challenged.[174]

Vermont Benefit Corporations shareholders have legal standing to bring a "benefit enforcement proceeding" against the directors for a failure to meet the general public benefit purpose or a specific purpose adopted in the corporate charter.[175] Discussing the new law, Jeffrey Hollander, co-founder of Seventh Generation remarked:

> There's little doubt that there is a financial advantage for companies that commit to a corporate philosophy that goes beyond profits. I believe that over time there will be increasing financial benefits because it will become easier for investors, who want to support responsible businesses, to identify businesses that are organized primarily around that purpose.[176]

3. The California Variation

Effective January, 2012 California introduced two new entities—the Benefit Corporation and the Flexible Purpose Corporation.[177] The Benefit Corporation, much like that adopted in Maryland and Vermont, is formed for a public purpose and directors will take into account the interest of stakeholders, such as shareholders, employees, customers, suppliers, the environment, and the

---

[172] VT. STAT. ANN. tit. 11A, § 21.05(2) (2012).

[173] VT. STAT. ANN. tit. 11A, § 21.10(c) (2012).

[174] Deskins, *supra* note 132, at 1072.

[175] VT. STAT. ANN. tit. 11A, §§ 21.09(e), 21.13 (2012).

[176] Bruce Edwards, *New Law Keeps with Vt's Social Conscience*, RUTLAND HERALD 2, June 13, 2010, *available at* http://www.vermonttoday.com/apps/pbcs.dll/article?AID=/RH/20100613/BUSINESS/100619977/-1/VBJ.

[177] Debra Bowen, *Two New Types of Corporations Effective January 1, 2012*, CAL. SEC'Y OF STATE, http://www.oswald-yap.com/wp-content/uploads/2010/05/flexible-purpose-corp-and-benefit-corp.pdf(last visited Aug. 19, 2013).

community in decision-making.[178] The Flexible Purpose Corporation, or "FlexC," is similar to a benefit corporation and in addition provides the entity the opportunity to designate an additional purpose for which it is formed— its own special purpose in its organizing document.[179]

In California, retailer Patagonia became the first corporation to register as a Benefit Corporation. For Patagonia's CEO, Yvon Chouinard, one of the primary reasons his company adopted Benefit Corporation status was the legal recognition of the company's moral mission.[180] Mr. Chouinard was outwardly pleased "to know that his company, which had become his life's work, would carry on long after him and would be able to stay true to the principles he instilled in it."[181]

While the legislative requirements governing Benefit Corporations may vary slightly between the states, the need to provide a general public benefit represents a common ground between them. Since Benefit Corporations are committed to providing a public benefit, a question arises as to whether tax benefits should be available to support the work of these entities, similar to those tax benefits available for nonprofit organizations. To answer this question, it is necessary to first explore the nature of the nonprofit organization and the rationale upon which tax benefits for nonprofits are based. This will be covered in Part IV. Part V will then consider whether the nonprofit tax benefits should be extended to Benefit Corporations.

IV. TAX BENEFITS ARE AVAILABLE TO ENTITIES MEETING NONPROFIT STATUTORY REQUIREMENTS

Those nonprofit organizations that meet the statutory requirements of Internal Revenue Code § 501(c)(3) receive two

---

[178] Cal. Corp. Code § 14620(b)(2012) (adding Part 13 to Division 3 of Title 1 of the Corporations Code, relating to benefit corporations).

[179] *The New ABC's of California Corporations*, KAYE & MILLS 2, http://www.kayemills.com/articles/new-abcs-of-california-corporations.html (last visited Aug. 19, 2013).

[180] Aiden Livingston, *To B or Not to B? Weighing the Benefits of Benefit Corporations*, MASHABLE (Mar. 2, 2012), http://mashable.com/2012/03/02/benefit-corporations/.

[181] *Id.*

primary tax benefits: (1) exemption from taxation on their income associated with their exempt activities, and (2) the ability to receive tax deductible contributions. Most scholars are in agreement that "these tax benefits have contributed to the size and success of the charitable sector."[182] Tax-exempt organizations represent a significant segment of the national economy.[183] In 2010, public charities reported $1.51 trillion in revenue, $1.45 trillion in expenses and $2.71 trillion in assets, indicating that the revenue of reporting public charities grew 40.8 percent over the decade, expenses grew 51.5 percent, and assets grew 38.1 percent.[184]

A. The Tax Preferred Status of Charitable Organizations

Organizations that come within Code § 501(c)(3) are either private foundations or public charities. While a detailed discussion of these differences is beyond the purposes and scope of this paper, the primary distinction between the two is that a public charity generally has more broad based public support than a private foundation.[185] A more generous charitable contribution deduction is also available for contributions made to public charities than those made to private foundations.[186]

What types of organizations qualify for these tax benefits? Code § 501(c)(3) defines exempt organizations as:

---

[182] Miranda Perry Fleischer, *Theorizing Charitable Tax Subsidies: The Role of Distributive Justice*, 87 WASH. U. L. REV. 505, 513 (2010). (Section 501(c)(3) represents the most widely known class of exempt organizations and will be the focus of this discussion. The Code also recognizes about thirty other categories of tax-exempt entities. These other entities (with a few exceptions) are not eligible to receive tax-deductible contributions. According to the most recent Statistics of Income released by the IRS in December 2012, nonprofit charities exempt under 501(c)(3) reported nearly $2.7 trillion in assets and over 1.48 trillion in revenue for 2009); *see* Paul Arnsberger, *Nonprofit Charitable Organizations*, 2009, STATISTICS OF INCOME BULLETIN 1 (FALL 2012), http://www.irs.gov/PUP/taxstats/productsandpubs/12eofallbulteorg.pdf.

[183] Amy S. Blackwood, Katie L. Roeger, & Sarah L. Pettijohn, *The Nonprofit Sector in Brief: Public Charities, Giving and Volunteering, 2012*, URBAN INST. 1, http://www.urban.org/UploadedPDF/412674-The-Nonprofit-Sector-in-Brief.pdf (last visited Mar. 28, 2014).

[184] *Id.*

[185] IRS Charity Classification: Private Foundation or Public Charity?, NOLO (Aug. 2013), http://www.nolo.com/legal-encyclopedia/irs-charity-classification-private-foundation-public-charity.html.

[186] I.R.C. § 170 (2014).

> Corporations, and any community chest, fund, or foundation, *organized and operated exclusively* for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, *no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation* (except as otherwise provided . . .), and *which does not participate in, or intervene in* (including the publishing or distributing of statements), *any political campaign* on behalf of (or in opposition to) any candidate for public office.[187]

This definition indicates that the 501(c)(3) organization has four distinct characteristics: (1) it is organized for an exempt purpose; (2) it is operated for an exempt purpose; (3) it ensures that net earning do not inure to a private benefit; and (4) it limits its political activities.[188]

1. Organized for an Exempt Purpose

To qualify for tax exempt status under 501(c)(3), an organization must be organized for charitable exempt purposes.[189] Defining "charitable" for purposes of tax exemption has been the subject of much discussion.[190] Commentators agree that Congress has not given any clear indication of the meaning of "charitable," although there is some support for the notion that the exemption broadly provides "benefits resulting from the promotion of the general welfare."[191] While charitable goals have been broadly interpreted, "as a general rule such organizations must provide some

---

187 I.R.C. § 501(c)(3) (2014) (emphasis added).

188 *Id.*

189 I.R.C. § 501(a), (c)-(d); § 401(a).

190 *See, e.g.*, Lars F. Gustafsson, *The Definition of "Charitable" for Federal Income Tax Purposes: Defrocking the Old and Suggesting Some New Fundamental Assumptions*, 33 HOUS. L. REV. 587, 590 (1996).

191 H.R. REP. NO. 1860, 75th Cong., 3d Sess. 19 (1938); *see also* BRUCE R. HOPKINS, THE LAW OF TAX EXEMPT ORGANIZATIONS § 5.2 (8th ed. 2003); Gustafsson, *supra* note 190, at 596-97.

type of 'community benefit' in the form of fulfilling needs not being met by the private market."[192] In the popular sense, the term "charitable" has often been associated with relief for the poor and distressed.[193] However, the legal sense of the term, which is currently found in the Treasury Regulations and used for purposes of tax exemption, is much broader:

> The term "charitable" is used in section 501(c)(3) in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration in section 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of "charity" as developed by judicial decisions. Such term includes: Relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency.[194]

In addition to serving an exempt purpose, the organization cannot act contrary to public policy.[195] For example, a private school, while serving an educational purpose, will not qualify as charitable organization unless it adopts a racially nondiscriminatory admissions policy.[196] In order to meet the statute's organizational requirement, the organization's articles of incorporation should include:

> (1) a purpose clause, which limits the purposes of the organization to one or more exempt purposes described in Section 501(c)(3); (2) A powers clause, which limits the organization's activities to those that further its exempt purposes; [and] (3) A dissolution article, which dedicates

[192] Miranda Perry Fleischer, *Equality of Opportunity and the Charitable Tax Subsidies*, 91 B.U. L. REV. 601, 607 (2011).

[193] HOPKINS, *supra* note 191, at § 5.1.

[194] Treas. Reg. § 1.501(c)(3)-1(d)(2) (2014).

[195] IRS, 1985 EO CPE Text, ACTIVITIES THAT ARE ILLEGAL OR CONTRARY TO PUBLIC POLICY (1985), *available at* http://www.irs.gov/pub/irs-tege/eotopicj85.pdf.

[196] Rev. Proc. 75-50, 1975-2 C.B. 587.

> the organization's assets solely to exempt purposes, and ensures that upon dissolution of the organization, any remaining assets will be distributed for one or more exempt purposes, or to one or more Section 501(c)(3) exempt organizations or the federal or state government . . .[197]

2. Operated for an Exempt Purpose

The operational test requires that the organization be operated exclusively for one or more exempt purposes.[198] This standard is not met if more than an insubstantial part of its activities are not in furtherance of an exempt purpose. Even if the organization carries on a trade or business, this will be permissible as long as the entity furthers an exempt purpose.[199]

The ability of the nonprofit to engage in an unrelated trade or business has always caused concerns about unfair competition with for-profit businesses.[200] Instances of unfair competition date back as far as 1874 when the Metropolitan Museum of Art in New York City began to sell photos of museum paintings to the public.[201] New York University's ownership of the Mueller Macaroni Company in the 1940s, which resulted in Mueller's nonprofit status, sparked concerns of unfair competition that led to the adoption of the unrelated business income tax in 1950.[202] While the unrelated business income tax requires a nonprofit to pay taxes on income that is not related to its exempt purpose, the unrelated business income tax does not bring in significant tax revenue.[203]

The U.S. Small Business Administration identified unfair competition as "an issue for the 1980s."[204] It continues to be an issue

---

[197] FRANCES R. HILL & BARBARA L. KIRSCHTEN, FEDERAL AND STATE TAXATION OF EXEMPT ORGANIZATIONS 2-67 (1994).

[198] The word "exclusively" has been interpreted to mean "primarily." Treas. Reg. § 1.501(c)(3)-1(c)(1) (2014).

[199] Treas. Reg. § 1.501(c)(3)-1(b)(1)(iii) and (c)(1).

[200] JAMES T. BENNETT & THOMAS J. DILORENZO, UNFAIR COMPETITION: THE PROFITS OF NONPROFITS 1-2 (1989) (citing Edward Skloot, *Should Not-For-Profits Go into Business?* HARV. BUS. REV. (Boston, MA), Jan./Feb., 1983, at 20).

[201] *Id.*

[202] *Id.* at 2.

[203] Edward Pound, Gary Cohen, & Penny Loeb, *Tax Exempt!*, 19 U.S. NEWS AND WORLD REPORT (October 2, 1995) at 36.

[204] BENNETT, *supra* note 200 at 9 (quoting Small Business Administration). U.S.

today. The most recent data available from the IRS, for the 2009 tax year, indicates that while over 42,000 tax-exempt organizations filed an information return, less than half reported any unrelated business and most had no tax liability after subtracting deductions from gross unrelated business income.[205] Consider, for example, the well-known organization, The PGA Tour. This entity is exempt from tax under Code §501(c), but the income generated by this nonprofit is staggering. The PGA Tour had total revenue of approximately $973 million in 2011 and reported taxable unrelated business income of only $1.7 million.[206] These figures do not put the PGA Tour at risk of loss of its nonprofit status. It is only when the nonprofit organization's primary purpose becomes the furtherance of an unrelated trade or business that the organization risks loss of its exempt status.[207]

3. Private Inurement and Private Benefit Prohibition

Private inurement is receipt by an organization insider of benefits not commensurate with that individual's contribution to the entity (*e.g.*, unreasonable compensation).[208] Receipt of more than an incidental private benefit by those who are not insiders is also prohibited, unless the benefit is received as part of the organization's exempt activities.[209] If an organization operates for the benefit of the creator of the organization, her family, or others associated with the organization, the organization does not operate for an exempt purpose.[210] According to the legislative history, the language against private inurement was added to "provide assurance that the exemption for charities was limited only to those institutions that

Small Business Administration, Office of Advocacy. 1984. Unfair competition by nonprofit organizations with small businesses: An issue for the 80's, 3rd ed., Washington, D.C. Office of the Chief Counsel for Advocacy, U.S. Small Business Administration.

[205] *Unrelated Business Income, Tax Year 2009*, IRS, http://www.irs.gov/pub/irs-soi/09ubisnapshot.pdf (last visited Dec. 5, 2013).

[206] PGA TOUR Form 990 (2011) *available at* http://www.espn.go.com/pdf/2013/121313/OTL_-_PGATour990.pdf.

[207] Treas. Reg. 1.501(c)(3)-1(c)(1).

[208] *See generally* IRS, 1990 CPE Text, TAX EXEMPT ORGANIZATIONS WITH FOR-PROFIT SUBSIDIARIES, *available at* http://www.sdlaw.com/files/Download/subsidiaries.htm.

[209] *Id.*

[210] Am. Campaign Acad. v. Comm'r, 92 T.C. 1053, 1065–66 (1989).

have no element of personal gain and that are exclusively devoted to exempt purposes."[211]

4. Political Activities

The Code imposes limitations on the political activities of charitable organizations.[212] Since 1954, charities have been prohibited from participating in political campaign activity, which includes activities such as contributing campaign funds, endorsing a candidate, or displaying campaign signs, or distributing literature for a candidate.[213] A charitable organization can engage in a certain amount of lobbying activities.[214] Rather, the requirement is that such activities not be substantial.[215] In addition, charitable organizations are permitted to engage in advocacy.[216] For example, an organization is permitted to advocate for or against legislation related to the environment, but must not use that advocacy as a way of taking a position for or against a particular candidate for public office.[217]

B. Why Offer Tax Benefits To Charity?

The notion of preferred tax status for organizations with a social purpose or public mission is not unique to our modern tax system. As illustrated in Table 3, preferential tax treatment pre-dates the passage of the Sixteenth Amendment in 1913.[218]

---

211 44 Cong. Rec. 4150 (1909) (remarks of Sen. Bacon).

212 Treas. Reg. 1.501(c)(3)-1(c)(3).

213 *Id.*

214 *Id.*

215 I.R.C. § 501(c)(3); *see also* Treas. Reg. § 1.501(c)(3)-1(c)(3) (2014). The IRS has explained that the determination of whether such activities are substantial will be determined bases on all the relevant facts and circumstances, including the time and expense devoted to these actions. *See* IRS, Measuring Lobbying: Substantial Part Test, http://www.irs.gov/Charities-&-Non-Profits/Measuring-Lobbying:-Substantial-Part-Test.

216 Treas. Reg. 1.501(c)(3)-1(c)(3)(ii)(b) (2014).

217 Mary Ann Hofmann, *Political Activity: A Primer for Nonprofits*, 30 NONPROFIT WORLD 20 (2012).

218 U.S. CONST. amend. XVI.

Table 3: The Development of the Rules for Tax Exempt Organizations[219]

ACT	TAX TREATMENT
Tariff Act of 1894	First statutory Federal income tax exemption for charitable organizations: "nothing herein contained shall apply to …corporations…or associations organized and conducted solely for charitable, religious, or educational purposes."
The Payne Aldrich Tariff Act of 1909	Exempted from corporate excise tax "any corporation or association organized and operated exclusively for religious, charitable, or educational purposes, no part of the income of which inures to the benefit of any private stockholder or individual."
Tariff Act of 1913	Exempts from Federal income tax "any corporation or association organized and operated exclusively for religious, charitable, scientific, or educational, no part of the net income of which inures to the benefit of any private shareholder or individual."
1917 Income Tax Act	Charitable contribution deduction added for contributions to organizations and associations organized and operated exclusively for religious, charitable, scientific, or educational purposes, or to societies for the prevention of cruelty to children and animals.

Notwithstanding the significance of charities in our society and the history of these provisions, "no consensus exists as to the purpose of either tax exemption or the charitable deduction."[220] A variety of reasons have been given to explain the tax benefits accorded to nonprofit entities: (1) taxation is based on the wherewithal to pay, (2) these organizations relieve a government burden by providing goods and/or services that the government would otherwise have to provide, (3) nonprofits promote pluralism, and (4) nonprofits are efficient providers but have limited access to capital.

[219] STAFF OF JOINT COMM. ON TAXATION, 109TH CONG., HISTORICAL DEVELOPMENT AND PRESENT LAW OF THE FEDERAL TAX EXEMPTION FOR CHARITIES AND OTHER TAX-EXEMPT ORGANIZATIONS (2005).

[220] Fleischer, *Theorizing*, *supra* note 182, at 514.

1. Wherewithal to Pay

Boris Bittker and George Rahdert support the tax exemption for nonprofits, in part, based on the fact that the nonprofits do not have the "ability to pay," which is one of the foundations on which taxation is based.[221] Since nonprofits lack a profit motive and generally distribute their funds to beneficiaries, calculating adjusted gross income for these organizations is administratively infeasible.[222] If tax-exempt organizations were stripped of their exempt status, "computing their 'net income' would be a conceptually difficult, if not self-contradictory task."[223] According to Bittker and Rahdert, this difficulty results from the legal and accounting principles by which adjusted gross income is calculated, because those principles are based on the fact that the organization operates under a profit motive.[224] For example, there is the issue of whether dues and contributions would be the considered gifts or business income. On the expenditure side, there is the issue of whether the expenses for the conduct of the organization's activities would be deductible as ordinary and necessary expenses or non-deductible since they were not spent in furtherance of a profit motivated activity.[225]

Even if this income could be measured, Bittker and Rahdert assert it would be difficult to set tax rates on this income since this tax would ultimately be paid by the nonprofit's beneficiaries.[226] In fact, if these entities were taxed, the "predictable losers would be the beneficiaries."[227] Henry Hansmann is one scholar who has taken issue with these conclusions on the grounds that most income of nonprofits comes not from contributions but from the sale of goods or services, and even if such income came from contributions, making a matching of expenses and income is less complex than perhaps Bittker and Rahdert suggest.[228]

---

[221] Boris I. Bittker & George K. Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Taxation*, 85 YALE L.J. 299, 305 (1976).
[222] *Id.* at 307.
[223] *Id.*
[224] *Id.* at 307-08.
[225] Rob Atkinson, *Theories of the Federal Income Tax Exemption for Charities: Thesis, Antithesis, and Syntheses*, 27 STETSON L. REV. 395, 409 (1997).
[226] Bittker & Rahdert, *supra* note 221, at 305.
[227] Atkinson, *supra* note 225, at 409.
[228] Henry Hansmann, *The Rationale for Exempting Nonprofits from Federal Income*

2. The Public Benefit and Relief of a Government Burden

One of the most compelling reasons supporting the federal tax benefits for nonprofit organizations is that these organizations produce public goods, goods that provide a public benefit.[229] These goods or services can either be considered inherently good or can be provided to those who are in need.[230] "Charities provide primary public benefits in two ways; especially good goods to ordinary people, and ordinary goods to the especially deserving."[231] In a thin market, "demand for a product is so small that no commercial firm could make a profit selling it. Because of their subsidies which artificially lower costs, nonprofits can serve such a market."[232] Jurists have recognized the value of this function as well. In a concurring opinion in a case involving a New York tax exemption, Supreme Court Justice Brennan stated that, "private, nonprofit organizations contribute to the well-being of the community . . . and thereby bear the burdens that would otherwise have to be met by general taxation, or be left undone, to the detriment of the community."[233] "[T]he [g]overnment is compensated for the loss of revenue by its relief from the financial burden which would otherwise have to be met by appropriations from other public funds."[234]

There is also the possibility of market or contract failure.[235] In order for a market to operate efficiently, ideally consumers would be able to assess the quality of goods or services prior to purchase.[236] In

Taxation, 91 YALE L.J. 54, 59 (1981).

229 *Id.* at 68.

230 Atkinson, *supra* note 225, at 402.

231 *Id.*

232 BENNETT & DILORENZO, *supra* note 200, at 26.

233 Walz v. Tax Comm'n of the City of N.Y., 397 U.S. 664 (1970) (Brennan, J. concurring).

234 H.R. REP. NO. 75-1860, at 19 (1938).

235 Henry Hansmann, *The Role of the Nonprofit Enterprise*, 89 YALE L.J. 835, 849-51 (1980) (advocating this theory) (cited by Lester M. Salamon & Helmut K. Anheier, *Social Origins of Civil Society: Explaining the Nonprofit Sector Cross-Nationally* 1, 14 (John Hopkins Comp. Nonprofit Sector Project, Working Paper No. 22 1996), *available at* http://ccss.jhu.edu/wp-content/uploads/downloads/2011/09/CNP_WP22_1996.pdf ; also cited by Barbara Bucholtz, *Reflections of the Role of Nonprofit Associations in a Representative Democracy*, 7 CORNELL J. L. & PUB. POL'Y 555, 567-68 (1998)).

236 Henry Hansmann, *Economic Theories of Nonprofit Organization*, *in* ECONOMIC THEORIES OF THE NONPROFIT SECTOR 27-42 (W. Powell, ed., 1987) *available at*

instances where this is not possible, a for-profit entity may have an incentive to curtail quality to enhance profits whereas a nonprofit that is unable to distribute net earnings does not have the same incentive to lower quality.[237] This results in a public perception that goods provided by a nonprofit are of higher quality.[238]

3. Promoting Pluralism

Pluralism is another often-cited rationale for the tax exemption of nonprofits.[239] "[T]he promotion of a healthy pluralism is often viewed as a prime social benefit of general significance."[240] Advocates of this theory "emphasize the role that charities play in providing creative and diverse solutions to society's problems in offering alternative viewpoints in the arts and culture, in countering government power, and . . . enhancing experimentation."[241] Having a charitable deduction in place allows the individual taxpayer to be more engaged in deciding which projects should receive support thereby likely increasing the individual's commitment to that particular project.[242] Allowing a deduction for charitable contributions is more efficient than direct grants made by the government because direct grants would likely require a broad based income tax increase which might not be in proportion to how much a taxpayer values the good or service being subsidized.[243] This method does not require value-based judgments, with the only inquiry being whether the entity provides public goods or service.[244] Allowing taxpayers to have a say in which projects to fund, as opposed to having the government direct such efforts, enhances pluralism and

http://www.ppge.ufrgs.br/giacomo/arquivos/eco02072/hansmann-1987.pdf.

237 *Id.*

238 While this issue is beyond the scope of this article, interested readers may wish to consult BENNET & DILORENZO, *supra* note 200, and Hansmann, *supra* note 228, for consideration of whether the higher quality perception represents reality.

239 Fleischer, *Equality, supra* note 192, at 610.

240 Green v. Connally, 330 F. Supp. 1150, 1162 (D.D.C.), *aff'd sub nom.* Coit v. Green, 404 U.S. 997 (1971).

241 Fleischer, *Equality*, *supra* note 192, at 610.

242 *Id.* at 613 (citing Saul Levmore, *Taxes as Ballots*, 65 U. CHI. L. R. 387, 406 (1998)).

243 Mark P. Gergen, *The Case for a Charitable Contribution Deduction*, 74 VA. L. REV. 1393, 1404 (1988).

244 Fleischer, *Equality*, *supra* note 192, at 612.

often results in a greater commitment by the individual to the project.[245] The donative intent behind voluntary contributions to charitable organizations is also considered an indication of a good or service being undersupplied either in the market or by the government, and thus in need of a subsidy.[246]

4. Limited Ability to Raise Capital

Hansmann was one of the first to apply an economic subsidy based argument for tax exemption.[247] Relying on economic theory, Henry Hansmann concluded that the prohibitions against private inurement and distributions of net earnings make it difficult for nonprofit organizations to attract capital.[248] Their inability to raise adequate capital, maintains Hansmann, prevents them from operating as efficiently as possible.[249] In addition, Hansmann asserts that nonprofits are also susceptible to contract failure, meaning for example, that donors pledging an amount to an organization for a specific purpose could not verify whether, in fact, the funds were put toward that purpose.[250] In Hansmann's view, the tax exemption afforded to nonprofit organizations served as a necessary subsidy to help negate these detriments.[251] Taking the view that contract failure was the key for obtaining the subsidy allowed Hansmann to support the subsidy without reference to the merits of the goods or services provided.[252]

It should be noted that movements in the social sector have been underway to improve the ability of nonprofits to raise capital by helping to increase the exchange of information between nonprofits and donors.[253] New intermediate organizations, such as the Robin Hood Foundation and New Profit, evaluate the performance of

---

[245] Saul Levmore, *Taxes as Ballots*, 65 U. CHI. L. REV. 387, 405-07 (1998)).

[246] JOHN D. COLOMBO & MARK A. HALL, THE CHARITABLE TAX EXEMPTION, 147-48 (1995)

[247] Fleischer, *Theorizing*, *supra* note 182 at 518.

[248] Hansmann, *supra* note 228 at 72-75.

[249] *Id.* at 72

[250] *Id.* at 67-69.

[251] *Id.* at 75.

[252] *See generally* Fleischer, *Equality*, *supra* note 192, at 609 n.30 (discussing the economic subsidy theory and others).

[253] *See, e.g.*, Robert S. Kaplan & Allen S. Grossman, *The Emerging Capital Market for Nonprofits*, HARV. BUS. REV. (Boston, MA), Oct. 2010, at 114.

nonprofits to monitor which use donations most effectively by reporting on the social outcomes achieved by the entity.[254] This information will help direct donor funds to the most-effective nonprofits.

V. TAX EXPENDITURES ARE AN IMPROPER SUBSIDY FOR BENEFIT CORPORATIONS

"Taxes are the price we pay for a civilized society," is an often-quoted rationalization for the necessity of a broad based system of taxation.[255] The tax structure plays a major role in shaping social issues. Tax structures in competitive political systems, such as that which we have in the United States, are part of a political equilibrium.[256] Whether it is the tax incentives provided for homeowners that encourage home ownership, the accelerated depreciation deductions that encourage business investment, the deductions for charitable contributions that encourage charitable giving, the social security payments to ensure assistance in retirement, the progressive tax rates, or the excise taxes imposed on tobacco products that discourage such purchases, there is no doubt that tax policies shape society.[257] "[C]ompetition between political parties for support from utility maximizing voters of differing political influence forces the government to choose a tax structure based on the loss in support— or, political costs— associated with different tax sources."[258] For example, the federal budget debate over the most effective use of government resources has no doubt been shaped not only by the current economic downturn, but also by differences between the

---

[254] *Id.*

[255] Compania General de Tabacos de Filipinas v. Collector of Internal Revenue, 275 U.S. 87, 100 (1927) (Holmes, J., dissenting). Justice Holmes' statement from his dissent is engraved above the entrance to the IRS Headquarters in Washington, D.C.

[256] *See* Lawrence W. Kenny & Stanley L. Winer, *Tax Systems in the World: An Empirical Investigation into the Importance of Tax Bases, Administration Costs, Scale and Political Regime*, 13 INT'L TAX & PUB. FIN. 181, 181 (2006).

[257] I.R.C. § 163(h) (homeowner tax incentive); I.R.C. § 168 (accelerated cost recovery); I.R.C. § 170 (charitable deduction); 42 U.S.C. § 402 (Old-Age and Survivors Insurance Benefit Payments) (2012); I.R.C. § 1 (tax rates); I.R.C. § 5701 (tax on tobacco products); *see also* Mystica Alexander & Timothy Gagnon, *The Roberts Court: Using the Taxing Power to Shape Individual Behavior,* 23 U. FLA. J.L. & PUB. POL'Y 345, 350-54 (2012) (discussing the effects of tax policies on society).

[258] Kenny & Winer, *supra* note 256, at 183.

political parties.[259]

A. Tax Expenditures Are Subsidies

It is important to understand the broader tax structure within which the tax preference for nonprofit organizations is expressed. The tax system is at the heart of the debate over the federal budget and the question of how to lead American out of its economic downturn. Faced with a deficit of $15 trillion, lawmakers on both sides of the political aisle recognize that a valid budget initiative must include government spending cuts, although a consensus cannot seem to be reached on where those cuts should be.[260] And while the concept of direct spending is readily understood (e.g., government support of Social Security and Medicaid), the term "tax expenditure," which represents indirect government spending, is less well known.[261] More commonly known as tax breaks or loopholes, tax expenditures are "departures from the normal tax structure . . . designed to favor a particular industry, activity, or class of persons."[262]

1. Tax-Favored Treatment is Tantamount to a Direct Expenditure

The term "tax expenditure" is attributed to Stanley Surrey, former Assistant Secretary of the US Treasury for Tax Policy during the Kennedy Administration, who was convinced that some tax preference provisions in the Internal Revenue Code were essentially forms of government spending, although not treated as such for

---

[259] *See generally* Tom Cohen, *Hope for Compromise Recedes as Budget Debate Begins*, CNN (Mar. 14, 2013), *available a*t http://www.cnn.com/2013/03/13/politics/obama-congress/.

[260] *See, e.g.*, Annie Lowrey, *Balanced Budget Dispute is Fiscal and Philosophical*, N.Y. TIMES, Mar. 12, 2013, *available at* http://www.nytimes.com/2013/03/13/us/politics/balanced-budget-fight-is-philosophical-and-fiscal.html; *see also* Brian Knowlton, *The Battle in Congress on Spending and Debt*, N.Y. TIMES, (Sept. 29, 2013), http://www.nytimes.com/2013/09/30/us/politics/questions-and-answers-on-a-possible-government-shutdown.html?_r=0.

[261] *See* STANLEY S. SURREY & PAUL MCDANIEL, INTERNATIONAL ASPECTS OF TAX EXPENDITURES: A COMPARATIVE STUDY 9 (1985) (summarizing the tax expenditure concept).

[262] PAUL R. MCDANIEL & STANLEY S. SURREY, INTERNATIONAL ASPECTS OF TAX EXPENDITURES: A COMPARATIVE STUDY 3 (1985).

budget purposes.[263] He believed these provisions were favored by politicians to provide subsidies that might not otherwise be feasible if subject to the same scrutiny received by direct government spending programs.[264] In 1967, Secretary Surrey directed his staff to compile a list of the tax provisions that were in the nature of expenditures, and he advocated that production of such a list be incorporated as a mandatory annual requirement.[265] In response to this, the Congressional Budget Act of 1974 requires the Administration to annually report tax expenditures as part of the annual budget submission.[266] While these are included in the budget submission, interestingly, these expenditures do not impact budget/spending and the information on tax expenditures can only be found in the appendix to the submission.[267] "In Washington, however, tax expenditures aren't considered spending programs. They're considered tax breaks."[268]

Picking up on Surrey's theme of the problem with tax expenditures, political scientist Chris Howard has dubbed these expenditures the "hidden welfare state."[269] To Howard, "the hidden welfare state illustrates a greater range of political possibilities for social programs in the United States than we are accustomed to seeing."[270] Since tax expenditures generally do not undergo the same degree of analysis as direct spending, the criteria by which they are to be evaluated are often not clearly articulated resulting in a certain

---

263 Jeffrey H. Kahn, *Personal Deductions: A Tax "Ideal" or Just Another "Deal"?*, 2002 L. REV. MICH. ST. U. DETROIT C. L. 1, 9 (2002).

264 STANLEY S. SURREY & PAUL MCDANIEL, TAX EXPENDITURES 3 (1985)*Id.*

265 Bruce Bartlett, *Spending Through the Tax Code*, FORBES, May 28, 2010, *available at* http://www.forbes.com/2010/05/27/finance-economy-tax-code-opinions-columnists-bruce-bartlett.html.

266 Congressional Budget Impound Control Act of 1974, Pub. L. No. 93-344, 88 Stat. 297 (1976).

267 Leonard Burman & Marvin Phaup, *Tax Expenditures: The Big Government Behind the Curtain*, VOX EU (Nov. 17, 2011), http://voxeu.org/index.php?q=node/7287.

268 Brad Plumer, *Why You Should Care About Tax Expenditures (Really)*, WASH. POST (Sept. 1, 2011, 3:17 PM), http://www.washingtonpost.com/blogs/wonkblog/post/why-you-should-care-about-tax-expenditures-really/2011/09/01/gIQAEr2quJ_blog.html.

269 CHRISTOPHER HOWARD, THE HIDDEN WELFARE STATE: TAX EXPENDITURES AND SOCIAL POLICY IN THE UNITED STATES 10 (1997).

270 *Id.*

level of ambiguity that shifts the costs of administration away from the government and on to individuals, corporations, and other parties.[271]

Suzanne Mettler refers to tax expenditures as "the submerged state."[272] As two commentators suggest, Mettler claims that "the relative invisibility of tax expenditures undermines democracy because their relative obscurity makes it more difficult for citizens to understand how government programmes affect them. Lobbyists can sneak expensive ineffective subsidies into the tax code that would never pass muster as direct spending programmes— think ethanol tax credits."[273] As a result of this, voters may not fully understand the cost of expenditures, allowing the government to be larger and more inefficient than might be permitted if citizens had full information.[274]

2. Tax Expenditures Amount to One-Quarter of Total Government Spending

The economic effect of tax expenditures is substantial. A recent National Bureau of Economic Research Working Paper states that based on Treasury estimates, 2011 income tax expenditures by the federal government will amount to $1.2 trillion.[275] Overall, income tax expenditures amount to one-quarter of total spending.[276] Ranking number seven on a list of the ten largest tax expenditures in 2011 was the Charitable Deduction totaling $43.9 billion.[277]

B. Subsidies are Improper for Benefit Corporations Because Benefit Corporations are not Like Charities

Given the Benefit Corporation's focus on serving a social

[271] *Id.* This shift in costs results from the ever-increasing time and cost associated with the complexity of the Tax Code.

[272] Suzanne Mettler, *Reconstituting the Submerged State: The Challenges of Social Policy Reform in the Obama Era*, 8 PERSPECTIVES ON POL. 803, 804 (2010).

[273] Leonard Burman & Marvin Phaup, *Tax Expenditures: The Big Government Behind the Curtain*, VOX EU (Nov. 17, 2011), http://voxeu.org/index.php?q=node/7287.

[274] *Id.*

[275] Leonard E. Burman & Marvin Phaup, *Tax Expenditures, The Size and Efficiency of Government, and Implications for Budget Reform* 6 (Nat'l Bureau of Econ. Research, Working Paper No. 17268, 2011), *available at* http://www.nber.org/papers/w17268.pdf?new_window=1.

[276] *Id.*

[277] *Id.* at 9.

mission, it is not surprising that some have considered the possibility of special tax privileges for such entities.[278] At present, these organizations receive no federal tax benefits similar to those available to charitable organizations, although there are signs that there may be calls for such treatment on the road ahead.[279] For example, Philadelphia became the first city in the nation to provide a financial incentive for sustainable businesses when a tax concession for a for-profit Certified B Corporation branded entity ("B Corp.") at the local level was adopted in 2009.[280] For 2012 through 2017, twenty-five eligible B-Lab corporations, or other organizations meeting sustainability standards, will receive a $4,000 tax credit against the Business Privilege Tax.[281]

Before considering whether Benefit Corporations should qualify for special federal tax treatment, such as that reserved for nonprofit organizations, it is important to note that there is an ever-increasing blurred line between nonprofit and for-profit entities. For-profit social enterprises are increasingly stepping into roles traditionally held by the government or nonprofit sector and are fully willing to put public mission above profitability. Take, for example, Google.org, the philanthropic, yet for-profit, arm of Google.[282] Google.org is

---

[278] For example, Andrew Kassoy, co-founder of B-Lab, has stated that the goal "will be to use this new corporate form as a platform for states or municipalities or federal governments to offer procurement, investment, or tax incentives for benefit companies. So in the dream scenario when you have companies obligated to create public benefit you can measure the externalities those companies are internalizing and say they should be taxed at a lower rate than a C corporation." *The B Corporation: A Business Model for the New Economy*, CAPITAL INST. (last updated Aug. 2012), http://capitalinstitute.org/metrics/b-corporation-business-model-new-economy#.Uzq5bk1OW70.

[279] *See, e.g.*, MASS. GEN. LAWS ch. 59, §5 (2014) (exempting the personal property of charitable organization from local taxation, but no such exemption exists for the property of state Benefit Corporations).

[280] PHILA., PA., CODE § 19-2604(10) (2009), *available at* http://www.phila.gov/philacode/html/_data/title19/chapter_19_2600_business_privi/19_2601_Definitions_.html.

[281] PHILA., PA., CODE § 19-2604(10)(c)(i), *available at* http://www.phila.gov/philacode/html/_data/title19/chapter_19_2600_business_privi/19_2601_Definitions_.html.

[282] *See* Sheryl Sandberg, *About Google.org*, GOOGLE OFFICIAL BLOG (Oct. 11, 2005), http://googleblog.blogspot.com/2005/10/about-googleorg.html; *see also* Katie Hafner, *Philanthropy Google's Way: Not the Usual*, N.Y. TIMES (Sept. 14, 2006), http://www.nytimes.com/2006/09/14/technology/14google.html?pagewanted=all&_r=0 (stating that "unlike most charities," Google.org is for-profit).

considered for-profit because it is free to distribute its profits, but it is nonprofit in its mission, which is to address some of the world's problems, rather than to obtain profit maximization.[283] Google's announcement of its creation of a for-profit charity caused mixed reactions both within and outside of the nonprofit sector.[284]

For example, Marcus S. Owens, a tax lawyer in Washington who spent a decade as director of the exempt organizations division of the Internal Revenue Service, expressed concern over the organization's long-term ability to maintain its dedicated funding: "'It's possible the shareholders of Google might someday object, especially if we go into an economic depression and that money is needed to shore up the company.'"[285] Professors Malani and Posner argue that Google.org's for-profit status will pose an obstacle to fulfilling its goals:

> The problem with for-profit charities is that they forfeit all the state and federal tax benefits available to nonprofit charities . . . For example, even if the Google charity is successful, Google may be reluctant to increase funding of the entity and the charity may have difficulty raising funds from donors because contributions to the for-profit Google charity are not deductible. This raises a puzzle. . . . If it turns out that Google's charitable efforts benefit poor countries more effectively that those of nonprofits with similar missions, why should the tax code steer donors to the nonprofits rather than to Google?[286]

Tax benefits for Benefit Corporations are unadvisable for three reasons: (1) It is by no means certain that the purposes of the Benefit Corporation will dovetail with those in Code § 501(c)(3) and accompanying regulations and the corporation's fulfillment of public purposes is not easily assessed; (2) Benefit Corporations do not

---

[283] *See* Hafner, *supra* note 282.

[284] *See* Christopher Quay, *Nonprofit Sector Has Mixed Reactions to Google's For-Profit Charity*, NAT'L COMMITTEE FOR RESPONSIVE PHILANTHROPY (Sept. 15, 2006), https://www.ncrp.org/news-room/news-2006/296-nonprofit-sector-has-mixed-reactions-to-googles-for-profit-charity (Noting that while Diana Aviv, the CEO of Independent Sector is "optimistic about Google.org's decision to operate as a for-profit," the executive director of the National Committee for Responsive Philanthropy, Richard Cohen, expressed concern over "questions of reporting, accountability, and oversight that are pretty daunting for the philanthropic sector").

[285] Hafner, *supra* note 282.

[286] Anup Malani & Eric A. Posner, *The Case for For-Profit Charities*, 93 VA. L. REV. 2017, 2020 (2007).

operate under the same distribution and private inurement restrictions as nonprofit organizations; and (3) Extending nonprofit tax benefits to Benefit Corporations will undermine the efforts of the charitable sector.

1. Benefit Corporations Do Not By Definition Engage in Charitable Activities and the Extent to Which They Fulfill a Public Purpose is Not Easily Assessed

As explained at the start of Part IV, the Internal Revenue Code and accompanying Treasury Regulations place limitations on the types of activities that an entity can engage in to qualify for the tax benefits of Code §501(c)(3).[287] The organization must be both organized and operated to further an exempt purpose.[288] Through these exempt activities, charitable organizations provide public goods that would otherwise have to be provided by the government.[289]

More recently, scholars have begun to call for a reassessment and expansion of the tax benefits provided to nonprofits to the for-profit social enterprise sector. Relying on the example of Grameen Bank, a nonprofit Bangladeshi organization whose social mission is to "decrease poverty in rural Bangladesh by granting small, collateral-free loans primarily to poor women villagers,"[290] Hadley Rose has called for an expansion of Code § 501(c)(3) to include social enterprises formed to meet both social and economic goals.[291] Rose points out that if Grameen Bank were operated under US charity law, its nonprofit status would be in jeopardy.[292]

Professors Malani and Posner also argue that nonprofit form should not be a prerequisite to tax subsidies. They note that if the

---

287 *See* 26 U.S.C. § 501(c)(3) (2012); Treas. Reg. 1.501(c)(3)-(1) (as amended in 2008).

288 Treas. Reg. 1.501(c)(3)-1(b)-(c) (as amended in 2008).

289 *See, e.g.*, Malani and Posner, *supra* note 286 at 2029-31 and Hansman, *supra* note 235 at 848-49.

290 Hadley Rose, Comment, *The Social Business: The Viability of a New Business Entity Type*, 44 WILLAMETTE L. REV. 131, 131 (2007).

291 *Id.* at 149-56.

292 *Id.* at 134 ("In the US, the Bank would be in danger of running afoul of numerous exemption doctrines, including the exempt purpose requirement, the commerciality doctrine, the private benefit doctrine, the prohibition against certain joint ventures, the Unrelated Business Income Tax ('UBIT') and the Excess Benefit Tax ('EBT')").

public goods theory is what underlies tax breaks for charitable nonprofits then "the tax deduction for charitable contribution should be made available to any firm for-profit or nonprofit— that engages in appropriate activities that benefit third parties."[293] They argue that if tax breaks are to be provided for community-benefit activities at all, they should be based only on the fact that a community benefit is being provided, not on whether the entity meets the requirements of the nonprofit form.[294] Even if one agrees with this position, it is unclear how "community benefit" is to be defined for this purpose. Presumably, for-profit entities seeking nonprofit tax breaks should have to meet the activity standards of Code § 501(c)(3). However, applying this approach to Benefit Corporations is problematic, as there is no one provision that defines the parameters of the Benefit Corporation's social mission, let alone not one that neatly fits within the definition of charitable activities upon which Code §501(c)(3) is based.[295]

A look at the Vermont Benefit Corporation statute is instructive on this point.[296] The statute requires a benefit corporation to "have the purpose of creating general public benefit,"[297] which in turn is defined as "a material positive impact on society and the environment, as measured by a third-party standard, through activities that promote some combination of specific public benefits."[298] Notably, however the statute does not require that the general public benefit be consistent with the charitable activities defined in Code § 501(c)(3). Further, glaringly absent is any hint at a limitation on those Benefit Corporation activities that will not further a general or specific public benefit. Such a limitation is a hallmark of a nonprofit enterprise.[299] Without some limitation, taxpayers would

[293] Malani & Posner, *supra* note 286, at 2030-31.

[294] *Id.* at 2064-2065.

[295] *See* Joseph M. Binder, *A Tax Analysis of the Emerging Class of Hybrid Entities*, 78 BROOK. L. REV. 625, 651-52 (2013) (arguing that, because of the "unusually broad list of activities" that allow a B corporation satisfy B-Lab's broad purpose standards, a B corporation may qualify as such without actually "reliev[ing] the government of the need to provide public goods or services")

[296] VT. STAT. ANN. tit. 11A, § 21.01 et seq. (2012).

[297] VT. STAT. ANN. tit. 11A, § 21.08(a) (2012).

[298] VT. STAT. ANN. tit. 11A, § 21.03(a)(4) (2012).

[299] *See* I.R.C. 501(c)(3) (2012); Treas. Reg. 1.501(c)(3)-1(a) (as amended in 2008) (providing that an organization must be both organized and operated

subsidize not only the public benefits provided by the Benefit Corporation, but also those activities engaged in purely to maximize profits. Distinguishing between the two would also impose administrative challenges.

Consider the scope of the recent Benefit Corporation law enacted in Delaware on July 17, 2013, with an effective date of August 1, 2013.[300] Delaware requires that the Benefit Corporation be intended to produce a public benefit, which is defined as "a positive effect (or reduction of negative effects) on [one] or more categories of persons, entities, communities[,] or interests . . . including, *but not limited to*, effects of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious, scientific[,] or technological nature."[301] Given the breadth of this definition, it cannot be said that a Delaware Benefit Corporation necessarily serves a charitable purpose, or supplies a public good that the government would otherwise have to provide. Several other states contain similarly problematic definitions of "general public benefit" or "public benefit":

exclusively for one or more exempt purposes).

300 DEL. CODE ANN. tit. 8, § 361 (2014).

301 DEL. CODE ANN. tit. 8, § 362(a)-(b) (2014).

Table 4: Defining a General Public Benefit

STATES
Arkansas, Arizona, California, Hawaii, Illinois, Louisiana, Massachusetts Nevada, New York, Oregon, South Carolina, Rhode Island, Virginia, Washington D.C.
STATUTORY LANGUAGE
"General public benefit" means a material positive impact on society and the environment, taken as a whole, assessed against a third party standard, from the business and operations of a benefit corporation.[302]
STATE
COLORADO
STATUTORY LANGUAGE
"Public benefit" means one or more positive effects or reduction of negative effects on one or more categories of persons, entities, communities, or interests other than shareholders in their capacities as shareholders, including effects of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious scientific, or technological nature.[303]
STATE
NEW JERSEY AND VERMONT
STATUTORY LANGUAGE
"General public benefit" means a material positive impact on society and the environment by the operations of a benefit corporation through activities that promote some combination of specific public benefits.[304]

While states vary somewhat in their definitions of "public benefit" or "general public benefit," one commonality is that they all define the term broadly. Kyle Westaway and Dirk Sampselle highlight concerns with the breadth and ambiguity of the general public

[302] ARK. CODE ANN. § 4-36-103(a)(5) (2014); ARIZ. REV. STAT. ANN. § 10-2402(3) (2014); CAL. CORP. CODE § 14601(c) (West 2014); D.C. CODE § 29-1301.02(a)(5) (2012); HAW. REV. STAT. § 420D-2 (2013); 805 ILL. COMP. STAT. 40 § 1.10 (2013); LA. REV. STAT. ANN. § 12:1803(A)(6) (2014); MASS. GEN. LAWS ANN. ch. 156E, § 2 (2014); NEV. REV. STAT. ANN. § 78B.040 (West 2014); N.Y. BUS. CORP. LAW § 1702(b) (2014); OR. REV. STAT. ANN. § 60.750(3) (West 2014); S.C. CODE ANN. § 33-38-130(A)(5)(McKinney 2013); R.I. GEN. LAWS § 7-5.3-2(5) (2014); VA. CODE ANN. § 13.1-782 (2013).

[303] COLO. REV. STAT. § 7-101-503(2) (2013).

[304] N.J. STAT. ANN. § 14A:18-1(2013); VT. STAT. ANN. tit. 11A, § 21.03(4) (2014).

benefit language.[305] First, they note that the term "material" is not defined.[306] Further, they argue, "society and environment are words conjuring enormous concepts so nebulous and extensive that it is difficult to know their actual or intended limits[.]"[307] Finally, the "as assessed against a third-party" language raises a question as to whether "a benefit corporation that fails to meet its third-party standard's requirements also fail[s] to uphold its purpose of creating a general public benefit" or whether it is simply a "threshold duty of a benefit corporation simply to find a third-party standard to assess its pursuit of its material impacts."[308]

In addition, as explained in Part II, at present definitive statutory guidance on how to assess whether a Benefit Corporation is fulfilling its public purpose is virtually nonexistent. Granted, the model legislation, as adopted by many states, requires the Benefit Corporation to submit an Annual Benefit Report which has been prepared in accordance with third party standard to ensure that organizational decisions have been made in accordance with the entity's general or specific public purposes, but these requirements are vague.[309] Further, there is no requirement that the Annual Report be reviewed or audited by the third party, only that the Benefit Corporation directors adopt some third party standard, but no particular standard is required.[310] There is also no statutory

305 Kyle Westaway & Dirk Sampselle, *The Benefit Corporation: An Economic Analysis with Recommendations to Courts, Boards, and Legislatures*, 62 Emory L.J. 999, 1034 (2013).

306 *Id.*

307 *Id.*

308 *Id.*

309 See, for example, the Benefit Corporation of Arkansas (§4-36-103(a)(10)), which explains that the third party standard should be comprehensive in considering stakeholder, and developed by an entity that is independent of the Benefit Corporation, has adequate expertise in corporate social and environmental policy to be considered credible, and is transparent, meaning that information about the third party is publicly available. Absent is any specific discussion of what types of action may be considered socially responsible and guidance on how the relative interests of stakeholders are to be weighed. ARK. CODE ANN. § 4-36-103(a)(10) (LexisNexis 2013), *available at* http://www.arkleg.state.ar.us/assembly/2013/2013R/Pages/BillInformation.aspx?measureno=HB1510.

310 See, for example, B-Lab's explanation of the adoption of a third party standard, which essentially vests all discretion with the board. *How Do I Select a Third Party Standard?*, BENEFIT CORP. INFO. CTR., http://benefitcorp.net/third-party-

framework for the third party review that explains how the performance standards are to be assessed, especially in light of the fact that Benefit Corporations are intended to take into account the effect of decisions on an array of stakeholders, not just the effect on the beneficiaries of its activities.[311]

It should also be noted that not all states have adopted the Annual Benefit Report Requirement. Delaware, for example, simply requires that a statement be made every two years, only to shareholders, that identifies the objectives the board has established to promote public benefit and the standards the board has applied to measure how well the entity has met those objectives.[312] Not only does the most recent Delaware statute not require any public reporting, annually or otherwise, but also does not mandate third party assessment.[313] Directors self-assess their actions and report to shareholders.

Concern about the lack of restrictions under which Benefit Corporations operate as opposed to those imposed on nonprofit entities was highlighted in a dispute in San Francisco over proposed legislation that would give special incentives to Benefit Corporations seeking city contracts.[314] The chief executive officer of the California Association of Nonprofits, Jan Masaoka, argued against any special treatment for Benefit Corporations based on this lack of regulation: "[t]here's no basis— of either historical disadvantage or evidence of benefit— to give these kind of nonprofit-like privileges to for-profit companies that have virtually no regulation or restrictions."[315]

standards/overview (last visited May 20, 2014). See also, for example, Arizona Benefit Corporation Statue which makes clear that a third party standard provider does not have to audit and certify the annual report. ARIZ. REV. STAT. § 4-10-2441 (LexisNexis 2014), *available at* http://www.azleg.gov/legtext/51leg/1r/adopted/h.1238-se-com.pdf.

[311] Model Legislation §301(a), *available at* http://benefitcorp.net/attorneys/model-legislation.

[312] DEL. CODE. ANN. tit 8, § 366(b)(2013).

[313] DEL. CODE. ANN. tit 8, § 366(c)(3) (providing that the bylaws of a public benefit corporation *may* require third-party assessment of the corporation's promotion of a public benefit).

[314] *See* Mark Hrywna, *Benefit Corporation in California Meets Chill in San Francisco*, THE NONPROFIT TIMES (Mar. 23, 2012), http://www.thenonprofittimes.com/news-articles/benefit-corporation-in-california-meets-chill-in-san-francisco/.

[315] *Id.*

2. Benefit Corporations Do Not By Definition Abide by the Non-distribution Constraint and Therefore Do Not Have Limited Access to Capital

The Benefit Corporation is a for-profit entity that is ultimately accountable only to its shareholders, even though decisions will be made which take into account the interests of a broad array of stakeholders.[316] As a for-profit entity there is an expectation that investors will receive a return on their investment, albeit likely a lower rate of return than would be expected from a purely profit driven entity.[317] As per Code §501(c)(3), the net earnings of a nonprofit organization cannot inure to the benefit of any organizational insider.[318] Even those who are not insiders cannot receive any substantial benefit from the nonprofit unless those benefits are received in furtherance of the organization's exempt activities.[319] In addition, upon dissolution of a nonprofit organization, the assets must be distributed in furtherance of an exempt purpose or to a federal or state government.[320]

Professors Malani and Posner contend that the non-distribution constraint is not an essential element of qualifying for tax benefits, and that a for-profit entity can, by contract, simply promise not to distribute profits to managers or workers.[321] The purpose of this would be to ensure that those running a for-profit charity would not have incentive to seek to increase profits for their own benefit by minimizing quality of goods and services.[322] Further, Malani and Posner propose that an independent auditor be retained to police adherence to the contract, similar to the oversight the state attorney

[316] Model Legislation §305(c), *available at* http://benefitcorp.net/attorneys/model-legislation (a corporation may opt to provide standing to non-shareholders in it ts articles of incorporation or bylaws); for example, in Delaware only stockholders that individually or collectively own more than 2 percent of the outstanding shares or if listed on a national exchange, 2 percent of shares, or shares with an vale of at least $2 million, can bring a legal claim to enforce the duty of the directors to balance the stakeholder interests.

[317] Model Legislation §301(a), *available at* http://benefitcorp.net/attorneys/model-legislation.

[318] 26 U.S.C. § 501(c)(3) (2012); 26 C.F.R. §§ 1.501(c)(3)- 1(c)(2).

[319] *Id.*

[320] 26 C.F.R. §§ 1.501(c)(3)-1(b)(4).

[321] Malani & Posner, *supra* note 286, at 2034-35.

[322] *Id.* at 2037.

general or the Internal Revenue Service has over the nonprofit entity.[323] These arguments, while not without some merit, are not effective in the context of Benefit Corporations as currently structured.

A look at the Vermont Benefit Corporation statute is instructive.[324] A review of the statute uncovers no limitations on the discretion of the directors in paying out the net profits of the corporation.[325] Apart from the general fiduciary duties of corporate law on the action of directors, directors can allocate net profits as they think best.[326] The way in which Benefit Corporation status can be terminated is also instructive. "A corporation whose status as a Benefit Corporation terminates shall immediately become subject to the obligations and rights of a general corporation."[327] As explained in Part II, this simply requires a two-thirds vote of shareholders.[328] Upon termination or conversion back to a C Corporation, there is no requirement that proceeds be distributed in furtherance of a public purpose. On termination, such proceeds will revert to the shareholders, and upon conversion to a C Corporation these assets will presumably be rolled over into the C Corporation. Commenting on hybrid social enterprises, Professor Galle correctly points out that, "all of the existing forms can readily be converted into a standard corporation. . . ."[329]

As hybrid entities that balance both profit and mission, Benefit Corporations are not required to limit their distributions in the manner dictated by Code §501(c)(3).[330] Even if one were to agree

---

[323] *Id.* at 2036.

[324] *See* VT. STAT. ANN. Tit. 11A, § 21 (2011).

[325] *Id.*

[326] *Id.* at § 21.09.

[327] *Id.* at § 21.02(a).

[328] *Id.* at § 21.07.

[329] Brain Galle, *Social Enterprise: Who Needs It?*, 54 B.C. LAW. REV. 2025, 2041 (2013).

[330] *See, e.g.*, Aurelien Loric, *Designing a Legal Vehicle for Social Enterprises: An Issue Spotting Exercise*, 5 COLUM. J. TAX L. 100 (2013-2014) (discussing the profit nature of the Benefit Corporation on behalf of its shareholders) ("Indeed, the Benefit Corporation allows the creation of double bottom line enterprises but does not require it: while a general public benefit purpose must exist, it does not have to be equal to the profitmaking purpose. Therefore, a Benefit Corporation can be turned primarily, although not exclusively, to profit maximization").

with Malani and Posner that such statutory restrictions are not essential to effectively fulfilling social mission, it is clear that as currently drafted there is no evidence that Benefit Corporation legislation ensures that these entities effectively fulfill their general and/or specific public benefit purposes. As an entity that constantly juggles shareholder and stakeholder interests, a certain component of Benefit Corporation decision making will always be carried out with an eye to profit and monetary return to shareholders. As observed by Steve Munch, "[b]enefit corporations should seek profit. But absent limits on this goal, the corporation's directors may still be subject to the real or imagined pressures of the market, and may thus occasionally privilege shareholder interests to the detriment of stakeholder positions."[331] Without distribution restrictions, the tax preference rationale based on the nonprofit's limited ability to raise capital would cease to apply. Dana Brakman Reiser has aptly termed the need of a charity to focus on benefits provided to others and the restrictions on distributions as "other-regarding orientation." She views this as an essential element of charity law.[332] As currently drafted, the Benefit Corporation legislation fails this standard.

3. Awarding Nonprofit Tax Benefits to Benefit Corporations Would Undermine the Charitable Sector

In 2013, there were at least 1.58 million nonprofits registered with the Internal Revenue Service, an increase of 21.5 percent since 2001.[333] However, charitable giving has not kept pace with the increased competition in the nonprofit sector, with charitable giving in 2012 only representing a four percent increase from 2011.[334] The economic recession with its accompanying rising unemployment and shrinking discretionary income has resulted in fewer government and donor dollars available for the nonprofit sector.[335] For example, in

---

331 Munch, *supra* note 46, at 191.

332 Dana Brakman Reiser, *Charity Law's Essentials*, 86 NOTRE DAME L. REV. 1, 3 (2011).

333 Amy S. Blackwood, Katie L. Roeger, & Sarah Pettijohn, *The Nonprofit Sector in Brief: Public Charities, Giving, and Volunteering, 2013*, URBAN INSTITUTE *available at* http://www.urban.org/UploadedPDF/412923-The-Nonprofit-Sector-in-Brief.pdf (last visited May 17, 2014).

334 *Id.*

335 Joseph J. Cordes, *Re-thinking the Deduction for Charitable Contributions: Evaluating the Effects of Deficit-Reduction Proposals*, 64 NATL. TAX J. 1001, 1021 (2011)

2008 overall individual charitable giving fell by 7 percent, and fell by 6.2 percent in 2009.[336] While charitable giving picked up by 2.1 percent in 2010, researchers conducting an annual survey of charitable giving, Giving USA, suspect that increases in giving will continue at a modest rate through 2016, with some organizations seeing little chance of filling their budget gaps in the near future.[337]

The nonprofit sector also faces possible threats to their long-standing tax benefits, as recent economic tensions have caused some to question anew whether it is time for the nonprofit sector to sacrifice some level of tax benefits.[338] For example, since 2009, the Obama administration has proposed to cap deductions allowable for contributions to charity at 28 percent, even though the top tax bracket at the time was 35 percent.[339] The Center for Philanthropy at Indiana University estimated that this cap would result in a decrease in charitable giving of 1.3 percent.[340] In the most recent budget proposal released in April, 2013, the administration once again has called for the cap of 28 percent, despite an increase in the highest tax rate to 39.6 percent.[341] Extending nonprofit tax benefits to for-profit entities could further undermine the charitable sector.[342] Due to the competition in the nonprofit sector, "greater entry by for-profits cannot be expected to enhance the degree of competition meaningfully, instead changing its nature to something less consistent with what is envisioned by granting public support to

(outlining proposals advanced for change in the charitable contribution deduction).

336 *Id.*

337 Holly Hall and Heather Joslyn, *Giving Recovery Lacks Momentum*, Say Charities, CHRONICLE OF PHILANTHROPY (Washington, D.C.) June 26, 2011, at 1.

338 Cordes, *supra* note 335.

339 Howard Husock, *The Obama Budget Proposal: Tax Increase on Charity*, FORBES, April 10, 2013, *available at* http://www.forbes.com/sites/howardhusock/2013/04/10/the-obama-budget-proposal-new-tax-on-charity/.

340 The Center for Philanthropy at Indiana University, *Impact of the Obama Administration's Proposed Tax Policy changes on Itemized Charitable Giving*, October, 2011, *available at* http://www.philanthropy.iupui.edu/files/research/obamataxchanges2011.pdf.

341 *Id.*

342 See, e.g., James R. Hines, Jill R. Horwitz & Austin Nichols, *The Attack on Nonprofit Status: A Charitable Assessment*, 108 MICH. L. REV. 1179, 1217 (2010). ("Greater charitable activity by for-profits need not displace activities by noprofits, though that is a plausible outcome.").

charity and its providers."[343]

VI. CONCLUSION

In a time of increasing calls for corporate social responsibility, the hybrid corporate form of business seems to provide the ideal vehicle for allowing a socially minded entrepreneur the latitude to put social mission and stakeholders ahead of the financial bottom line for shareholders. The notion of joining for-profit and nonprofit motivation is not a new one, and in-fact, the evolution of the Benefit Corporation has been a gradual process. Even among those who agree on the positive social value of Benefit Corporations, a question remains as to whether these entities should also be extended the tax benefits enjoyed by nonprofit organizations. The failure of Benefit Corporations to fulfill the long-standing requirements of nonprofit organizations and the lack of carefully articulated standards to assess fulfillment of social mission lead to the conclusion that Benefit Corporations, as currently designed, do not warrant special tax treatment.

343 *Id.* at 1219.