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In addition to valuing whether a tax policy is equitable, efficient, and administrable, I argue we should ask if a tax policy is politically just. Others have made a similar case for valuing political justice as democracy in implementing just tax policy. I join that call and highlight why it matters in one arena – tax exemption. I argue that politically just tax policy does the least harm to the democratic functioning of our government and may ideally enhance it. I argue that our right to an equal voice in collective decision making is the most fundamental value of political justice. To test this case, I evaluate our choice to exempt ‘social welfare organizations’ from the U.S. income tax. In addition to efficiency and equity, I also ask whether the policy is politically just in a democratic sense. I examine three models of democratic justice: liberal, republican, and deliberative. In making the democratic case I try to find commonalities among the three in order to further what an agreed upon notion of democratic justice might look like in the tax context. I contend that the notion of democratic justice must exist at the substantive level of Code. This Code level application demonstrates that the typical criteria of efficiency and fairness do not provide sufficient criteria to evaluate the justice of tax-exempt policy. There are likely significant other parts of income tax policy that need to be considered from the value of political justice as democracy as well.

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POLITICAL JUSTICE AND TAX POLICY: THE SOCIAL WELFARE ORGANIZATION CASE

INTRODUCTION

Much tax policy scholarship adopts the maximization of a social welfare function as its guidepost\(^1\) or attempts to show whether tax policy is unfair economically to some class of people.\(^2\) Tax policy scholarship that seeks to maximize a social welfare function is scholarship that considers how to enhance aggregate economic welfare through tax policy (a “best-results” theory, and also a tax policy focused on “efficiency”). By a fairness critique, I mean scholarship that primarily focuses on whether a tax policy unfairly advantages some group in usually an economic sense over another (in tax policy this is often described as either the criteria of “fairness” or “equity”).\(^3\) I argue we should also ask whether a tax policy is politically just. Others have made a case for the importance of political justice as


\(^2\) See, e.g., Reuven S. Avi-Yonah, *The Three Goals of Taxation*, 60 TAX L. REV. 1 (2006) (adopting both the maximization or social welfare and economic unfairness arguments, but also arguing that tax is used to regulate); C. Eugene Steurle, *And Equal (Tax) Justice For All*, in *Tax Justice: The Ongoing Debate*, 253 (Joseph J. Thordike & Dennis J. Ventry, Jr. eds. 2002) (arguing equity is a more fundamental value than efficiency and that we must measure people vertically and horizontally to ensure equal treatment according to ability and well-being).

democracy in implementing just tax policy.\footnote{See e.g. James R. Repetti, *Democracy and Opportunity: A New Paradigm in Tax Equity*, 61 VAND. L. REV. 1129 (2008) [hereafter Democracy and Opportunity] (arguing tax policy as fairness should be about providing equal opportunity to all citizens to achieve self-realization); Joseph T. Sneed, *The Criteria of Federal Income Tax Policy*, 17 STAN. L. REV. 567 (1965) (arguing that one of the factors tax policy sets out to accomplish is a “harmony between the income tax and the sought after political order”); Clinton G. Wallace, *Tax Policy and Our Democracy*, 118 MICH. L. REV. ___ (forthcoming 2020) (arguing we should build the democratic value of accountability into our making of tax policy).} I join them in calling for adding political justness to the consideration of tax policy and highlight why it matters in one arena – tax exemption. I advance the discussion also by arguing that politically just tax policy does the least harm to the democratic functioning of our government and may ideally enhance that functioning. I argue that our right to an equal voice in collective decision making is the most fundamental value of political justice (“equal political voice”).

To test this political justice value case, I consider our choice to exempt ‘social welfare organizations’ from the U.S. income tax.\footnote{Social welfare organizations derive an exemption from income tax from 26 U.S.C. § 501(c)(4).} In addition to the criteria of efficiency and equity, I also ask whether this tax policy is politically just in a democratic sense.\footnote{Others have made arguments about the justness of policy associated with charities based on political justice. For instance, Rob Atkinson has argued that public policy including tax policy ought to be designed in alignment with a republican conception of political justice with a healthy skepticism of voluntary organizations and most things provided by the state. Robert Atkinson, *Keep Republics Republican*, 88 TEX. L. REV. SEE ALSO 235, 246-47 (2010). In the social sciences, Rob Reich has argued that our current tax law regarding charity provides too much voice to the wealthy in our democratic order. ROB REICH, J UST GIVING, 195 (2018). I have previously argued for considering democratic justice in evaluating section 501(c)(5) tax exempt labor unions. Philip T. Hackney, *Prop Up the Heavenly Chorus: Labor Unions, Tax Policy, and Political Voice Equality*, 91 ST. JOHN’S L. REV. 315 (2017) [hereinafter Prop Up the Heavenly] (argued tax exemption policy for labor and business interests distinctly favored business interests and was therefore not democratically just).} I examine three models of democratic justice: liberal, republican, and deliberative. While I am inclined toward the deliberative form of democracy, I try to find commonalities among the three in order to further what an agreed upon notion of democratic justice might look like in the tax context. Also, I argue that the notion of democratic justice must exist at the substantive level of Code sections rather than just in the way tax
policy is made, the choice of base or whether the marginal rate structure is redistributive. This Code level application demonstrates that the typical criteria of efficiency and fairness do not provide sufficient criteria to evaluate the justice of tax-exempt policy. There are likely significant other parts of income tax policy that need to be considered from the value of political justice as democracy as well.

To be exempt from the corporate income tax as a social welfare organization, a nonprofit entity must not be organized for profit and must be “operated exclusively” for the “promotion of social welfare.” In 2016, more than 80,000 of these organizations were registered with the IRS, and as an aggregate they earned over $86 billion in revenue. Politically active groups like the NRA and the ACLU are social welfare organizations. So are some big health maintenance organizations. Finally, the sector is comprised of Rotary clubs, Kiwanis clubs, kids’ sports associations, homeowners’ associations and more.

I contend that social welfare organization tax exemption as a policy violates the principle of providing equal political voice in two fundamental ways. First, our tax policy arbitrarily uses a market model to distribute this benefit. This provides a greater subsidy to individuals with greater access to human and material resources as compared to those with limited resources. Secondly, and equally importantly, the highly vague standard of social welfare puts the IRS in the untenable position of deciding which organizations are furthering our best collective interest. This harms us in a political justice sense because it creates a collective choice mechanism that is not transparent and not made by the people, and because in that process it pollutes the appearance of justice of the IRS’s most important work, the collection of revenue. Because of the vague standard of social welfare and the requirements of tax privacy, the IRS is forced to make political

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8 JEREMY KHOULISH, FROM CAMPS TO CAMPAIGN FUNDS: THE HISTORY, ANATOMY AND ACTIVITY OF 501(c)(4) ORGANIZATIONS, URBAN INSTITUTE, 6 (2016) [hereinafter FROM CAMPS TO CAMPAIGN FUNDS]. See also Ellen P. Aprill, Examining the Landscape of Section 501(c)(4) Social Welfare Organizations, 21 N.Y.U. J. LEGIS. & PUB. POL’Y 345, 360-67 (2018), [hereinafter Examining the Landscape] (demonstrating that this number likely significantly undercounts the number of social welfare organizations in existence).
judgments in a nontransparent matter for us all. This violates both
equal voice and the appearance of equal voice.

Social welfare organizations are a significant part of civil society.9
By civil society, I mean the institutional spaces and organizations
outside of the government, and probably outside of economic power,
that facilitate collective decision making.10 This is made up of many
different types of institutions such as the press, voluntary
organizations, churches, schools, places where people publicly
congregate. All of the social welfare sector, including kid’s sports
associations and HMOs fit into this broad category. As such, they play
a large role in shaping and providing collective goods and services.
While these organizations are important to a democratic order and
ought not be hindered, administering a governmental system that
advances some of these interests has real implications for political
justice.

From a political justice as democracy perspective we should end
the policy for partisan organizations that engage in education and
advocacy regarding their respective issues. Unintuitively, taxing them
is the policy of neutrality as to these interests. To be clear, this policy
fails in an equity sense because it is only available to those interest
groups (i.e., organizations outside the government organized to
influence the government on the interests of its members)11 with the
capacity to make use of its benefits. Additionally, it fails in an
efficiency sense because it delivers a benefit to those who do not need
the help and gives nothing to those who do. The idea of an efficient

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9 Peter Dobkin Hall, Philanthropy, the Nonprofit Sector & the Democratic Dilemma, 142
Daedalus 139 (2013) (noting that nonprofits writ large are widely regarded as
“quintessentially civic associations,” while at the same time questioning whether they are all
truly above the fray and to be trusted).

10 Jurgen Habermas, Three Normative Models of Democracy, 1 Constellations 1, 8
(1994) [hereinafter Three Normative Models] (arguing that civil society is outside of the
government and the economic power and makes up the facility for people to form opinions in
the public sphere outside of those two significant forces).

11 See Philip T. Hackney, Taxing the Unheavenly Chorus: Why Section 501(c)(6) Trade
[hereinafter Taxing the Unheavenly] (defining the term interest group citing to John R. Wright,
Interest Groups and Congress: Lobbying, Contributions, and Influence 22-23 (1996) (internal
quotation mark omitted).
market is harmed in the process as well. Finally, it is politically unjust because the benefit is directly tied to the way we make collective decisions. It pollutes that process and harms equal political voice by providing it arbitrarily and primarily on a market-based model. A far better policy, for instance, would be for the government to give every person in the United States $100 a year to give to interest groups or advocacy organizations that best represent their interests. Finally, the political justice harm is magnified by the fact that the IRS is, and is seen to be, the approver of these groups. Thus, people who are entitled to a role in our collective decision making see government damage equal political voice. Worse yet, the people see it destroy equal political voice from the instrument of our government that must be seen to be fair in its collection of revenue.

What about the other organizations? Rather than directly working to shape collective decision making, these organizations provide collective goods and services. Delta Dental, described below in Part IV (E), provides insurance for dental services. Rotary club, described below in Part IV (F), connects businesspeople in a community to meet, speak with one another about important community matters, and to provide community service. Home-owners associations provide security, maintenance, and connectivity for neighborhoods.

From an equity standpoint, we might be concerned again at how the benefit likely accrues to these social welfare organizations unequally. But it’s harder here to make that evaluation. It may be from an efficiency standpoint that some of the services and goods are underprovided. Maybe neighborhoods need more services than that are already provided by local governments. Perhaps we don’t have enough HMOs and this subsidy helps improve market provision. The political justice analysis may provide some additional insight though. As structured, it fails on political justice grounds for two reasons, both associated with the vague standard applied. I believe our collective decisions should be shaped with an equal political voice in mind. Because the standard is so vague, we have not had a representative body of the people shape what collective goods get the imprimatur and benefits of the government. Instead that imprimatur and benefit is delivered arbitrarily and primarily through a market mechanism. Additionally, as in partisan organizations, the IRS is stamping its
approval on those decisions it deems to meet the standard in a nontransparent manner. This both robs the people of shaping its collective decisions and carries out that activity in a nontransparent manner. From a political justice standpoint, I believe we would be better off to eliminate the exemption altogether.

Like others, I am not expecting Congress to eliminate the provision anytime soon. If we are to maintain the preference, political justice would demand Congress elucidate clearer rules as to the bounds of those organizations. Clearer rules could eliminate some concern regarding the transparency of the process and provide a little more clarity that the people decided that specific activity ought to be aided through the system. We could also aim to improve the democratic nature of these organizations of civil society. We could adopt principles that the three democratic traditions agree upon in what civil society ideally would look like. One possibility is to limit the exemption to those organizations with limited revenue and a large membership core, such as many Rotary and Kiwanis clubs and kid’s sports recreation leagues. This shows more democratic promise in the large number of people who are involved and support these programs. We might require the organizations to have a truly community-based board and to fully promote robust civil dialogue. I have doubts that the latter is administratively feasible. It puts the IRS in the same problematic position already identified.

I compare a political justice analysis with two theories that have emerged as the dominant rationales for tax-exemption: contract failure and government failure. In the first there is a failure of the market to provide certain important goods and services. Exemption is then viewed as a subsidy to help provide a more efficient level of those goods and services. In the latter, our government will only provide the collective services and goods of the median voter. Exemption, in this

12 See Examining the Landscape supra note __.
theory, is viewed as a subsidy to allow minority groups to provide the collective goods and services they desire that are not provided by government. I conclude that while the two other theories continue to offer a useful lens to consider tax policy on the matter of tax exemption, adding a political justness factor is a vital factor to add. It enhances our ability to properly design tax policy. The two theories (contract failure and government failure) are myopic because they determine a sense of justness based on a vision of a perfect market. Fundamentally, such an approach is arbitrary in terms of justice. As for the application of a political justice critique to the rest of the tax code, this Article concludes that such a project is a worthwhile endeavor.

Part I will explain the adoption of a political justice analysis to critique tax policy and consider its benefits and its limitations. Part II will discuss the positive law associated with social welfare organizations and describe and categorize some of the activities that take place in the sector. Part III will consider previous analyses of theories of tax exemption including those that focus upon social welfare organizations. Part IV will analyze the exemption from income tax for social welfare organizations as well as the tax treatment of contributions both from an income tax and a gift tax perspective. Part V will conclude.

**PART I: WHY POLITICAL JUSTICE?**

In this part, I argue that the evaluation of the wisdom of a tax policy ought to include a discussion of political justice with an emphasis on democratic justice. In other words, rather than focusing only on a best results frame (in a largely economic sense), we ought to consider matters of a just and legitimate political system. That system ought to further equal political voice. The traditional values of equity and efficiency are largely driven by a best results vision of justice. We ought to consider a popular will sense of justice as well.

I first develop the moral case for why political justice as democracy is an important and vital value to consider in addition to efficiency and equity. I then discuss why democracy forms the basis of political justice. Because pure democracy is utopian in nature, however, I consider a few archetypal models of democracy in a pluralist imperfect
world. Reviewing these models allows us to apply real-world democratic options to tax policy. The three models include: liberal, republican, and deliberative democracy. Though I have in mind a more deliberative democracy vision, I include the other two to see where the three may have some commonalities. In those commonalities we might find principles that might inform a conception of political justice upon which we could have a consensus to make tax policy. Finally, I consider how we ought to think about the role of political justice as applied to the tax system.

A. Why Democratic Justice Instead of Another Type of Justice?

What are the fundamental criteria people use when they argue about the wisdom of a particular tax? Typically, experts will discuss the equity, efficiency, and administrability of a tax. For instance, the income tax is thought to be equitable because a taxpayer pays tax based on her ability to pay, with “income” determining the ability to pay.15 This is arguably fair based on an equal economic sacrifice of all taxpayers.16 The income tax is thought to be efficient, and thus perhaps just, because it generally taxes all sources of income the same. As such, it does not distort market choices beyond the charge laid across the economy.17 Efficiency in this economic sense might be thought of as just in a utilitarian sense as it might lead to a larger economic pie.

15 Alan Gunn, *The Case for an Income Tax*, 46 U. CHI. L. REV. 370 (1979). There are other senses of justice that philosophers have considered such as the benefit principle, for example, i.e., we should be taxed in accord with the benefits we receive from government or taxation ought to be transactional. This also suggests a “distributive” sense of justice – i.e., we each get our just deserts based on how much we benefit from government activity. Of course, in the economic sense of efficiency, in a perfect market with perfect information, any tax, except a lump sum tax, is inefficient necessarily because it harms the distributional system of the market.


17 Uneasy Case, supra note ___ at 62 (1996). Progressive and regressive rates challenge this rationale of course, but there may be reasons of efficiency to lay different rates across the economy as demonstrated by Zolt and Ramsey.
shared among citizens than would happen if a less efficient tax were used. Regardless of its just nature, in arguing for the correctness of a tax, experts today rely much on economic analysis and largely on a tax’s capacity to efficiently distribute burdens across taxpayers. The economic critique in tax today is king.

Liam Murphy and Thomas Nagel famously argued that tax scholarship focused on equity and efficiency is myopic in its assessment of the justness of tax matters. By assuming individuals are entitled to their pretax income, tax theories operate on a presupposition that the right to private property is a natural right rather than the conventional matter that it is. Murphy and Nagel highlight the way in which both the equity and efficiency arguments tend to rely upon this incorrect presupposition. That myopia includes another presupposition: that the market is a just way of distributing scarce goods and power. As Jane Mansbridge states, economists “not only accept the ‘marketplace’ vision of a society based on self-interest but make it an ideal.”

From a perspective of the domain of economics, the distribution of resources through perfect market mechanisms is ideal because those perfect market mechanisms supposedly deliver goods to those who value them most highly. But, standing on economics alone fails to do justice. To the extent the economic domain cares for moral matters, it tends to define them in a utilitarian manner alone. The economic method of critique is hollow firstly because, as stated, it fails to acknowledge the moral dimension of distributing scarce resources. It is hollow also because it does not fully describe the world within which we live. The market cannot actually clear all goods in an economically

18 **MYTH OF OWNERSHIP, supra note __**, at 23 (discussing the utilitarian justice basis of such arguments).

19 *Id.*

20 **MYTH OF OWNERSHIP, supra note __**, at 8.

21 **JANE J. MANSBRIDGE, BEYOND ADVERSARY DEMOCRACY, 17** (1983 Rev. Chicago Ed); see also Douglas Rae, *The Limits of Consensual Decision, 69 THE AM. POL. SCI. REV. 1270* (1975) (discussing that Knut Wicksell, and Buchanan & Tullock are wrong in claiming that consensual decision is socially efficient).

efficient manner. There is no pure market. We need a government entity to create and maintain social structures within which the market operates. A collective decision-making system controls the market instead. The focus on economics in tax policy scholarship obscures this necessary relationship of the system of taxation to the provision of collective properties.

Our system of taxation bears a fundamental relationship to our collective use of resources and our providing of collective properties. The idea of a collective property of society is one which “in order to change one person’s welfare with regard to this property one must change all or almost all of the other members’ welfare with regard to it.” Collective properties include our laws that regulate ownership of property, laws to regulate the environment, the distribution of resources. This list is likely endless, and endlessly debatable, but makes up the stuff of which we in society make laws about and operate a government to enforce. We raise taxes to provide these collective properties. And the tax system itself is a collective property. Importantly, the tax system as it operates necessarily creates and makes changes to collective properties existing in society. In other words, the tax system bears a reflexive relationship to collective properties themselves.

If economics by itself cannot establish the justness of a tax system, where might we look? Because taxation is a necessary element in establishing and maintaining a state in order to provide collective properties it necessarily impacts questions of political justice. As James Repetti notes the tax base and its progressivity should be shaped with thoughts of political justice in the sense of equality of opportunity. I push further to contend that the justice of the tax system should not simply end at the construction of the base and its progressive nature. We should consider ways in which individual code provisions may impact political justice.

There is a long philosophical tradition looking at the question of political justice. By political I mean how we decide what the group is

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24 Democracy and Opportunity, supra note __, at 1143. (“A tax system should be designed to achieve equal opportunity for self-realization as one of its principal goals.”)
going to do. There are a few different primary answers to the question of who ought to decide what the group is going to do: (a) no one, or anarchy, (b) some select group of people, or guardianship, and (c) everyone, or democracy.

In a previous article considering how to think of political justice as it relates to taxation, I discussed why we should prefer democracy as a matter of political justice over other forms of government such as guardianship or anarchy.\footnote{Prop Up the Heavenly, supra note \__, in Part II.} The case for democracy is at heart based on the principle of intrinsic equality.\footnote{In sketching that account of democracy, I relied heavily upon the work of Robert Dahl and thus repeat those references here. In particular, I relied upon: Robert A. Dahl, Democracy and Its Critics (1989); Robert A. Dahl, On Democracy (2015 2d ed.); Robert A. Dahl, How Democratic Is the American Constitution (2003 2d ed.); Robert A. Dahl, On Political Equality (2006) [hereinafter On Political Equality].} That is to say that no one is better than an individual in deciding what that individual should do in life. As a result, all individuals ought to have an equal say in what a relevant group decides to do. As Thomas Christiano explains, “A person’s right to participate in the shaping of the world she shares in common with others, which characterizes a well-functioning democracy, is grounded in her fundamental interests as a member of political society.”\footnote{Thomas Christiano, The Constitution of Equality 12 (2008) [hereinafter Constitution of Equality].}

Democracy is much more demanding of us than a majority rules principle.\footnote{See, e.g., John Dewey, Democracy and Educational Administration, in Intelligence in the Modern World: John Dewey’s Philosophy, 400 (1939).} Crucially, each member of the relevant group (typically all competent adults) must have an equal and real opportunity to have a say in the agenda regarding what the group is deciding about. This means all individuals must be afforded the ability to ask questions, seek relevant information, and hear arguments such that all individuals have an opportunity to fully understand the consequences of the decision at hand. Additionally, everyone must have a vote in any final decision. These requirements establish a principle Robert Dahl referred to as inclusion;\footnote{Democracy and Its Critics, supra note \__, at 126-27.} that value can also be described as political

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25 Prop Up the Heavenly, supra note __, in Part II.


29 Democracy and Its Critics, supra note __, at 126-27.
voice equality. This idea animates what I refer to here when I mention equal political voice.

Christiano adds another element to the principles of democracy. To have equality, equality must be seen, it must be publicly realized.\(^{30}\) Institutions “must be able to display the fact of their justice to ordinary persons.”\(^{31}\) In effect, the only way we can each know that we are getting equal respect in our polity is if that equality is public. The state itself is the most important institution in establishing this public reality.\(^{32}\)

The idea of equal political voice, and the publicity of that equal political voice, mean that to be politically just a tax system as it is structured should not harm equal political voice. It also should not be perceived to harm that equal political voice. The premise of the Article then is that our tax policy ought not be designed in a way that hurts the democratic functioning of our polity. A further premise is that we could design tax policy to improve that functioning. Finally, it is important that the tax system not be seen to harm equal political voice.

Though I work from this assumption, I accept that pure democracy is utopian. Large states cannot possibly meet the requirements of pure democracy and thus theorists within the democratic tradition must work on theories of polyarchy, rule of the many, instead. This has consequences for how we ought to think about realistic political justice.

The next section thus reviews efforts of political theorists to derive a democratic order workable in a plural world. First, I consider the elements Dahl suggests are necessary for a state to function well as a democratic order existing in a plural world. Additionally, though, I consider three models of democracy that are typical responses to pluralism: republican, liberal, and deliberative. These systems of democratic thought detail how such democratic values and arrangements might apply to substantive tax policy. I focus on the role of civil society in each of these traditions in the section below.

\(^{30}\) CONSTITUTION OF EQUALITY, supra note 28, at 46.

\(^{31}\) CONSTITUTION OF EQUALITY, supra note 28, at 51.

\(^{32}\) CONSTITUTION OF EQUALITY, supra note 28, at 53.
B. Three Democratic Theory Traditions

Once a group has achieved some size, ideal democracy becomes impossible. We cannot provide all individuals full democratic rights. In order to be democratic in nature, political theorists have determined that a polyarchy must adopt certain principles. It must allow the election of representatives of the people on a frequent basis. There must be freedom of speech to discuss matters of importance to the political system. Institutions outside of the government must provide robust information regarding the decisions before the government. There should be no hindrance on the formation of associations particularly of political variety, and all individuals should have each of these freedoms. Dahl lists seven specific institutions that are critical to a well-functioning polyarchy: (1) elected officials, (2) free and fair elections, (3) inclusive suffrage, (4) right to run for office, (5) freedom of expression, (6) alternative information, and (7) associational autonomy.

These principles are far from a claim to justice. It is impossible to give a succinct description of the rich democratic theory traditions to be found. For purposes of this article, however, I focus on three primary traditions, liberal, republican, and deliberative democracy. Each adopts democratic procedures like free and fair elections and freedom of expression. But they each order society a bit differently and prioritize different values.

The big distinction between the liberal and republican theories is the perspective the theorists pursue: individual or universal. By individual, I mean a theory that prioritizes individual rights and thus builds protections for individual freedom. By universal, I mean a theory that prioritizes the group instead of the individual. The procedural or deliberative democratic theories, at least in the

33 Democra C and Its Crics, supra note __, at 227.
34 Democra C and Its Crics, supra note __, at 227.
Habermas tradition, try to marry those two perspectives. It seeks to give honor to both the individual and the state through reasoned structured dialogue to generate a consensus will.

These traditions all struggle with a major challenge: the members of a political society fulfill two roles – that of maker of government and its matter. Individuals are both the agents and the objects of government. Thus, the individual and associations are always conflicted.

The liberal democratic theorist prioritizes protecting individual rights in that conflict. With a genesis in the work of John Locke, it emphasizes private property rights. The state is a mechanism to protect individual rights within a market frame-of-mind. In the liberal democratic view, a citizen’s “voting decisions have the same structure as the acts of choice made by participants in a market.” Still, a liberal democratic theorist supports political equality as an instrumental way to protect the rights of the individual to self-determination.

Civil society associations are critical to bringing citizen political voice to the legislature in the liberal model. But, the liberal theorist views these associations in a market model. John R. Wright, for instance, argues interest groups bring important information to the legislature to allow it to make better political decisions and law. The liberal model is sometimes referred to as a pressure group model. Liberal theorists often argue that pressure groups ought to be diverse and balanced so that the legislature is best able to find the most

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36 POLITICAL EQUALITY, supra note __, at 97, quoting Hobbes Leviathan.
38 Jurgen Habermas, Three Normative Models of Democracy, 1 Constellations 1, 3 (1994).
41 Thomas Christiano, The Rule of the Many, 251 (1996)
supported ideas. Additionally, the liberal vision promotes the idea that civil society might provide goods to a minority population that are different from those that are provided by the majoritarian state. Civil society also is a place to allow experimentation. As I will discuss below in Parts III and IV, we see many of these ideas advanced in making the case for tax-exemption from the federal income tax.

On the republican view, individuals obtain their highest achievement through collectively governing themselves at the level of the state. While republicans support a representative democracy, they neither support it for equality’s sake, nor because they explicitly support the right to democratic participation. Instead, the republican believes the individual finds virtue and freedom in a cooperative endeavor with the state. Thus, as Hanna Pitken states, for Edmund Burke, “government should rest on wisdom and not on will; the good of the nation emerges not from a general will but from ‘the general reason of the whole’”

Republican theory supports the primacy of the equality of the people of the community. However, rather than encouraging competition among individuals refereed by the state, republicans work to design a state that finds a common will of the people. This common-will is typically anchored in a cultural or religious tradition that provides substantial presuppositions for the proper order of the state. The republican tradition resonates with both the right and the left in our modern political sense of those words. The political right tradition is represented by the likes of Machiavelli and Hobbes. It is also a part

42 Id. (citing Joshua Cohen & Joel Rogers, Secondary Associations and Democratic Governance, 20 POL & SOC’Y 293 (1992); and Hannah Pitkin, The Concept of Representation, 142 (1967) [hereinafter Concept of Representation].


44 Three Normative Models, supra note __, at __. See also Political Truth, supra note __, at 283-84.

45 PHILIP PETIT, REPUBLICANISM: A THEORY OF FREEDOM AND GOVERNMENT, 8 (1997).

46 Concept of Representation, supra note __, at 169, citing Samuel H. Beer, The Representation of Interests in British Government: Historical Background, AM. POL. SCI. REV., 616 (1957).
of the thought of the founders in the work of Madison. The political left republican sense is found in the work of Rousseau.

The republican theorist fears the corruption of the government by faction. By faction, I mean groups representing selfish interests of citizens against the common interests of all the people of the state. In the older republican traditions, the theorists argued the defense against faction lay in aristocratic governance with some power shared with the many, such as the British House of Commons. In the modern thread of republicanism, the defense from faction involves the separation of powers as recommended by Montesquieu. Obviously, Madison in the Federalist papers talked about the concern of faction. He recommended a large government with a separation of powers to ensure against this form of corruption.

All the same, those in the republican tradition recognize associations and civil society as critical to a just political order. As the republican tradition began to accept the idea of a representational democracy and as the state increased in size and diversity, it began to also accept the importance of groups to represent individual interests. Some republicans like Philip Petit argue nondomination by the state is a highly important value and believe civil society is critical to preventing this type of domination by the state.

In the liberal tradition, individuals have rights that protect them from the state. In the republican tradition, individuals have positive rights to govern themselves through communicative action to form a general will, but they are not protected from state intervention in their lives. The protection is the political process. In the liberal tradition, winning the representative process in effect translates to success to carry out the market/governance ideas of the winners. The right number of votes should translate into certain policies if they do not

48 The Federalist No. 10, supra note __, at 48.
49 Democracy and Its Critics, supra note __, at 30.
51 Three Normative Models, supra note __, at 241.
violates the protected individual rights. Within the republican tradition, the political process is a dialogue in the context of a shared tradition in which the public collectively decides to pursue policies for the community.

Some theorists like Jane Mansbridge see the liberal and republican models as dead-ends of adversarial politics, solely based on self-interest. This is Hobbe’s model of politics where humans pursue “power after power that ceaseth only in death.” Deliberative democracy was born in this space. I rely primarily upon the views of Jurgen Habermas to present a deliberative democracy case. He often refers to his theory as the “discourse theory.” Though he draws from republican and liberal theories, he rejects both as failing to provide a just system.

Two modern facts inform his theory: the plurality of today’s world, and the governance disaster of World War II. By a plural society, I mean a society that is divided along “segmental cleavages.” “This exists where political divisions follow very closely, and especially concern lines of objective social differentiation.” The consequence of this plural world is there is no one cultural belief, such as a common religion, to provide a common base upon which to construct our governance. This leads him to anchor just governance in a community operating with a shared concept of communicative action, an idea described below. The lessons from World War II are the potential destructive nature of the state to the individual. This latter fact means that it is important to build safeguards for individuals against state domination.

A successful and politically just system “depends not on a collectively acting citizenry but on the institutionalization of the

52 Three Normative Models, supra note __, at 243.
54 Between Facts and Norms, supra note __, at 169-70.
57 Between Facts and Norms, supra note __, at 3-6.
corresponding procedures and conditions of communication, as well as on the interplay of institutionalized deliberative processes with informally developed public opinions.” 58 Habermas explains his theory is different from the republican theory because decentered from the state. It is different from liberalism because it does not employ constitutional norms to regulate a market mechanism. It relies upon communicative action. The idea of communicative action is that individuals have the capability of using their language to communicate with others, verify claims and take group oriented action based upon that communication. 59

Deliberative democracy as a model depends upon two spheres of communicative action: one at the legislative/administrative level that includes the branches of government and political parties that engage in discursive rationalization to create law, and the other as an autonomous public sphere anchored by civil society that engages in will-formation through communicative action. The public sphere is a separate space from the economic and the administrative and must be strong enough to maintain its own both against money and the administrative state. 60

The public sphere is broad and all-encompassing component of society whose most conspicuous member is the media. But the public sphere includes a wide range of spaces and people. Those spaces and people include the public talking in taverns and on the streets, at rock concerts and theater and church gatherings, all the way to isolated individuals digesting all types of media on their own. 61 That public needs be open and inclusive. It cannot harden into an organization and must have “unrestricted inclusion.” 62 The public sphere develops informal constructed opinions that are to be delivered through a

58 BETWEEN FACTS AND NORMS, supra note __, at 298.
59 BETWEEN FACTS AND NORMS, supra note __, at 18.
60 Three Normative Models, supra note __, at 249.
61 BETWEEN FACTS AND NORMS, supra note __, at 374.
62 Id.
“sluice” to the administrative structure.\textsuperscript{63} That public sphere needs “sufficiently inclusive participation” but its success relies more upon “the formal criteria governing how a qualified public opinion comes about.”\textsuperscript{64}

In Habermas’ vision of the public sphere the participants must take a second-person attitude and grant communicative freedom to the other in a “linguistically constituted public space.”\textsuperscript{65} Though certain other realms are related to that public sphere, such as religion, education and the family and science, morality and art, Habermas believes these fulfill different functions than the public sphere.\textsuperscript{66} At its best, the public sphere is filled with diverse voices who are “potentially affected” by a matter. Civil society, comprised of “a network of associations that institutionalize problem solving discourses on questions of general interest inside the framework of organized public spheres”\textsuperscript{67} orchestrates the public sphere. An energetic civil society is needed for the protection of liberal rights such as freedom of speech, association, assembly, press, and also the integrity and freedom of private life spheres.\textsuperscript{68}

Critics of Habermas’ vision of deliberative democracy argue that his focus on procedure alone is a failure. Though he recognizes the inequality of citizen resources he fails to advocate for a system that requires an equality of resources though he realizes that failure will lead to a failure of democratic rights for all.\textsuperscript{69} Habermas states regarding the matter of a welfare state and the relation between material and legal equality that “[i]f private and public autonomy are

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\textsuperscript{63} Cf. CONSTITUTION OF EQUALITY at 196 FN 6 (questioning the reasonableness of this assumption of Habermas that political will formation is likely to happen).
\textsuperscript{64} BETWEEN FACTS AND NORMS, supra note __, at 362.
\textsuperscript{65} BETWEEN FACTS AND NORMS, supra note __ at 361.
\textsuperscript{66} BETWEEN FACTS AND NORMS, supra note __ at 362.
\textsuperscript{67} BETWEEN FACTS AND NORMS, supra note __ at 367.
\textsuperscript{68} BETWEEN FACTS AND NORMS, supra note __ at 368.
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co-original, then this relation can, in the final analysis, be specified only by the citizens themselves.” In the end, Habermas believes justice is found primarily in a just democratic procedure, not in some particular allocation of resources.

In conclusion, though each tradition has a different focus and anchor upon which it believes justice resides, each also finds there is an importance in recognizing the equal rights of citizens, the promotion of freedoms of speech and association, and the deep importance of civil society in protecting these rights.

C. Why and Where does Democratic Justice Apply to Income Tax?

On its face, it might not appear that the income tax impacts political justice as democracy. We all might agree that the way a tax is enacted impacts political voice, but it is likely more difficult to see why democratic justice would apply to the substance of tax law. Accounting for income from a maker of widgets based on widgets sold and allowing a deduction for a basic business expense like paying the salaries of an employee who is making widgets may not seem to impact equal political voice. Nor would political voice seem to be playing a role in the burden Joe or Mary faced from their $40,000 or $100,000 salary.

At a deep level, the choice to employ a progressive income tax speaks to democratic justice in the sense that it might impact the level of economic inequality in a political system. Because those with greater resources typically have a greater ability to impact government decisions, a progressive income tax might be able to limit (or increase) those economic disparities in political voice. James Repetti has made the argument that the question of whether to utilize a progressive income tax is informed by a need to maintain equality of opportunity. Critical tax scholars have marshalled evidence to show the structure of the Code often applies in ways that negatively impact certain groups

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70 BETWEEN FACTS AND NORMS, supra note ___ at 414.

71 See Democracy and Opportunity, supra note __.

72 Id.
based on gender, race or sexual orientation. This is a political justice critique. By excluding the voices of individuals from these groups we as a country are visibly not providing equal political voice in shaping the laws.

Can the idea of political justice be found in individual Code sections? In income tax, we cast a wide-net so that the tax burden is spread across all activity and to provide as limited of opportunities as possible for avoiding the income tax. We also tax every conceivable entity that might generate income. At the same time, while we try to cast that net widely and grab up all activity and all entities, Congress removes certain activity and certain entities from taxation, or lowers taxation based on some activity or entity. It is in this space that I want to examine political justice in this Article.

To the extent the income tax provides a deduction for an activity that directly relates to political voice, the tax is impacting the popular will. For instance, allowing a deduction for lobbying expenditures or for political campaign expenditures impacts political voice. Also, to the extent the income tax does not tax organizations engaged in political voice activities, the tax is impacting popular will. In the case of the treatment of labor unions and their members I have argued that

73 See, e.g., Beverly I. Moran & William Whitford, A Black Critique of the Internal Revenue Code, 1996 Wis. L. Rev. 751 (1996) (arguing that the choices made in the Code systematically exclude the voices of black citizens from shaping the policies in the Code);

74 See e.g., 26 U.S.C. § 115.

75 26 U.S.C. § 501. Also, state and local political entities are in effect generally exempt from the income tax.

76 Under 26 U.S.C. § 162(e) we prohibit such deductions.

77 Under 26 U.S.C. § 527 we provide tax exemption to political organizations, though in § 527(e) we apply a tax to net investment income of these same organizations. Also, we require an individual who transfers an appreciated asset to a political organization to recognize gain upon the contribution to the political organization 26 U.S.C. § 84.
we should consider the political voice impact of deductions and tax-exemption.\textsuperscript{78}

In prior articles, I utilized interest group literature to show how providing exemption to business leagues and labor unions could amplify the political voice of persons with interest in asking the government to provide collective goods. Problematically, the benefit to the members of these organizations is of great use to members of interests who face little in the way of collective action challenges, and of highly limited, to no, use to persons who suffered severe collective action challenges (such as the poor).

In the analysis below, I consider these same themes of political justice associated with advocacy type organizations. But, the revenue and number of organizations that operate in this same interest group fashion is only a small part of the social welfare organization world.\textsuperscript{79} Over 70\% of the revenue in the social welfare organization context is earned by health providers and insurers.\textsuperscript{80} Social welfare organizations, however, also provide collective goods and services. How might matters of political justice relate to the tax policy as applied to these varied groups?

While it might be easier to see the problematic nature of granting interest groups a subsidy based on how much money they are able to attract to their particular cause, it might be harder to see in the case where an organization is directly carrying out social welfare. I believe political justice ought still to play a role in how we conceive of these provisions of collective goods. The next section reviews the universe of social welfare organizations and the legal structure applied to this diverse group.

\textbf{PART II: SOCIAL WELFARE ORGANIZATION LEGAL REGIME}

\textsuperscript{78} In \textit{Prop up the Heavenly} I argued that Congress’s choice to effectively stop labor union member from deducting union dues while allowing businessmen to deduct their dues was an unjust policy because it harmed the social choice function.

\textsuperscript{79} \textit{Examining the Landscape} supra note \_\_ at \_\_ (discussing the fact that only a relatively small part of the social welfare organization sector seems to be made up of advocacy or politically active organizations.

\textsuperscript{80} \textit{FROM CAMPS TO CAMPAIGN FUNDS, supra} note \_.

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Social welfare organizations include “[c]ivic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare . . . and no part of the net earnings of such entity inures to the benefit of any private shareholder or individual.”

It is believed the policy originated out of a comment from the U.S. Chamber of Commerce when Congress was enacting the income tax. The organization argued that certain organizations that perform “civic functions” should not pay tax.

A. The Law Regarding Qualifying as a Social Welfare Organization

A social welfare organization must operate “exclusively” for social welfare purposes. However, the IRS drafted regulations that interpret exclusively to mean “primarily engaged in promoting in some way the common good and general welfare of the people of the community.” A social welfare organization must exhibit a primary purpose of “bringing about civic betterments and social improvements.” The promotion of social welfare does not include participating or intervening in a political campaign. Operating either a social club or a business like a type of business operated for profit also does not meet a social welfare purpose. The type of activity that

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85 Id.

86 Id.
seems to be permitted or suggested is positive collective activity, rather than some private purpose.

The largest complaint about the section is the vagueness of the standard.87 The IRS itself has stated regarding the social welfare category: “section 501(c)(4) has been used by both the courts and the Service as a haven for organizations that lack the accepted essential characteristics of a taxable entity, but elude classification under other subparagraphs of 501(c).”88 Often the IRS finds that an organization that did not meet the requirements of being charitable under section 501(c)(3) fit the requirements of a social welfare organization. For example, an organization formed to assist older men by finding them new jobs and educating employers about the benefits of these skilled older men failed under section 501(c)(3), but qualified under (c)(4).89 Similarly, an organization that established and maintained a legal facility to build and operate a stadium for a municipality was found to not be charitable but to promote social welfare.90 In *Erie Endowment* an organization failed to qualify because it did not demonstrate that it was “a community movement designed to accomplish community ends.”91 However, in *Eden Hall* the court held that operating a women’s home as a vacation spot primarily for women who worked for Heinz Co. qualified for social welfare status.92 The court stated that an organization that “focused on one segment or slice

87 See, e.g., *Examining the Landscape*, supra note __, at 348 (referring to the vagueness of the standard as a “no mans land” though ultimately concluding it may serve a useful border boundary guarding purpose). But Cf. *A (Partial) Defense*, supra note __, at 445 (suggesting that Congress may very well have intended the broad standard as it has been applied by the IRS).


of the community” met the standard. The IRS announced it would not follow this decision. Marshalling resources in a nonprofit organization to solve a lack of adequate housing for low- and moderate-income groups satisfies the promotion of social welfare criteria. Likewise, a city plan to eradicate unemployment qualifies. To eradicate unemployment, corporations and other persons or entities contributed money. The organization then loaned that contributed money to those who would operate land, at least 10% of which was provided by the city. The IRS said the organization was “operated primarily to bring about civic betterment and social improvement.” An organization formed to supply water to residents of a particular community was found to promote social welfare because it used the profits to “raise the water table.”

A community operated a bus service where riders shared in the cost convinced the IRS it promoted social welfare because the services were available to all in the community. The IRS acknowledged though that the service was mostly used by the founders of the group. The IRS similarly approved an organization formed to operate a rural airport where the FAA had expressly found that there was a need for such a service and the municipality provided the land upon which the airport was to operate.

An organization formed to clean up spills in a city port was found to be exempt. Key to approval was that the service was supposedly available to everyone in the port. In contrast, Contracting Plumbers

93 Id.
was not found to promote social welfare. Problematically, the group formed to repair potholes on New York streets only repaired potholes caused by plumbers who were members of the organization. An organization that transmitted television signals only to members was found to not be operated primarily for social welfare, while an organization that provided a signal to anyone in the area met the exemption requirements.

The IRS held that a credit counseling organization formed to assist individuals with financial problems and to try to end the spate of personal bankruptcy qualified as a social welfare organization. Congress later became concerned about the abusive use of this classification and passed new rules regarding the operations of these types of organizations. Another revenue ruling of the IRS approved an organization formed to facilitate the resolution of consumer complaints. It was open to all people and was believed to help a significant segment of the community.

Pastimes often qualify as social welfare organizations. A gun range that sold annual memberships and ran gun safety courses was determined to be exempt. Similarly, the IRS found the operation of a roller-skating rink at reasonable charges to all in the community, if they pay the membership fee, to promote social welfare.

A series of rulings find that beautification of a city or city areas can qualify. A classic neighborhood association heavily involved in providing security patrols for the area through membership dues was found to be exempt under section 501(c)(4). In that ruling, anyone

101 Contracting Plumbers Cooperative Restoration Corp. v. United States, 488 F. 2d 684 (2nd Cir. 1974).
102 Id.
could become a member, and members and nonmembers alike had access to those community goods and services provided by the organization.\textsuperscript{109} The IRS denies status to organizations where residents must pay money in exchange for beautification or security.\textsuperscript{110} A group formed to help out businesses and residents of one city block was similarly found to not promote social welfare.\textsuperscript{111}

Health insurance related organizations make up the largest amount of revenue associated with social welfare organizations.\textsuperscript{112} This is a bit odd as in the Tax Reform Act of 1986, Congress eliminated commercial type insurance organizations such as Blue Cross Blue Shield from qualifying as exempt from the corporate income tax.\textsuperscript{113} Many of the Blue Cross organizations were organized under section 501(c)(4) themselves.\textsuperscript{114} An IRS CPE text from 1981 may provide some clues. In that text, the IRS acknowledges that it has long held certain prepaid medical plans meet the exemption requirements of a social welfare organization, in spite of the fact that the IRS has a policy against mutual benefit associations so qualifying.\textsuperscript{115} This was written before the enactment of section 501(m).

There is little guidance from the IRS on when a Health Maintenance Organization (HMO) qualifies as a social welfare organization.\textsuperscript{116} An IRS audit technique guide simply restates the basic

\begin{itemize}
\item \textsuperscript{109} Rev. Rul. 75-386, 1975-2 C.B. 211.
\item \textsuperscript{110} Rev. Rul. 77-273, 1977-2 C.B. 194.
\item \textsuperscript{111} Rev. Rul. 75-286, 1975-2 C.B. 210.
\item \textsuperscript{112} FROM CAMPS TO CAMPAIGN FUNDS at 6 (representing that health providers and insurers earned almost $63 billion of the $86 billion of revenue earned by social welfare organizations according to the 2014 IRS Business Master file).
\item \textsuperscript{113} 26 U.S.C. § 501(m).
\item \textsuperscript{114} William M. Miller, Phyllis D. Haney & Kenneth J. Earnest, \textit{Insurance, the Rule of 86}, 1997 IRS CPE text.
\item \textsuperscript{116} That which is out there mostly would suggest that these organizations do not so qualify. See, e.g., Rev. Rul. 75-199, 1975-1 C.B. 160 (Organization that paid sick and death

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requirements of operating as a social welfare organization in discussing HMOs.  

An HMO that served “underserved” members of the community was seen by the IRS as legitimately furthering social welfare. Organizations called individual practice associations (IPA) established pursuant to federal policy associated with HMOs are not operated exclusively for social welfare purposes. IPAs are entities that are made up of doctors’ practices that establish compensation arrangements with an HMO and who share various expenses such as technological and administrative. A court in 2008 found that an organization formed to provide insurance for members for their vision needs was not organized and operated exclusively for social welfare purposes because it operated primarily for its members “rather than the general welfare of the community.”

Social welfare organizations can engage in lobbying activities as a legitimate social welfare purpose. Lobbying refers to the activity of trying to get a public representative body to vote for or against a decision that is before that body. The IRS approved an organization that informed the public on controversial subjects and tried to influence legislation as a social welfare purpose. The IRS has found that lobbying for animal rights and for the rights of the unborn are both social welfare purposes. However, an organization engaged in civil disobedience was found to be engaged in activities “contrary

118 GCM 39829 (Sept. 10, 1990).
124 Rev. Rul. 76-81, 1976-1 C.B. 156.
to the common good and the general welfare of the people in a
community and thus are not permissible means of promoting the social
welfare.”

While lobbying activity furthers a social welfare purpose,
intervening in political campaign activity does not. To intervene in
a campaign means the act of encouraging people to vote for or against
candidates for public office. An organization who ranked candidates
as its primary activity failed to show it was operated for a social
welfare purpose because the ranking was provided to intervene in a
campaign. However, a social welfare organization can intervene in
a political campaign and still qualify as a social welfare organization
as long as it otherwise operates primarily as a social welfare
organization.

While it is not clear how much political intervention is too much,
the IRS seems to operate on the basis that 50% of activities or revenue
is too much. There are many who argue that “exclusively” should
be read to allow much less political activity. Others, like the Bright
Lines Project, argue that there is a lack of clarity in the qualitative

125 Rev. Rul. 75-384, 1975-2 C.B. 204. This limitation seems similar to the public policy
doctrine announced by the United States Supreme Court in Bob Jones Univ. v. United States,
discussing the public policy doctrine as it relates to social welfare organizations.


GPS won a famous case against the IRS that it was operated primarily for social welfare
purposes even though it ran many ads that appeared to be political ads in favor of a particular
candidate. See Robert Maguire How Crossroads GPS Beat the IRS and Became a Social
Welfare Group, Opensecrets News (Feb. 12, 2016) (describing the battle with the IRS)
available here https://www.opensecrets.org/news/2016/02/how-crossroads-gps-beat-the-irs-
and-became-a-social-welfare-group/

129 Examining the Landscape supra note __ at 347. The IRS has never defined the limits,
see Ellen P. Aprill, A Case Study of Legislation vs. Regulation: Defining Political Campaign
activities that are considered political intervention and recommend the IRS adopt clearer rules on what is political intervention.\textsuperscript{130}

Interestingly, Congress prohibits a taxpayer from deducting either lobbying or political campaign expenses.\textsuperscript{131} Up until 1962, Treasury regulations prohibited the deduction of lobbying expenses. The Supreme Court upheld this limitation in \textit{Cammarano v. Commissioner}.\textsuperscript{132} In 1962, Congress permitted the deduction of expenses that directly lobbied on issues germane to the taxpayer. Nevertheless, in 1993, the Clinton administration passed a law to again prohibit the deduction of these expenses.\textsuperscript{133}

Whatever the merit of any proposals for curing the lack of clarity in Treasury regulations or even the Code, the current vague status of the law seems to have been a big driver in the Tea Party crisis that arose in 2013.\textsuperscript{134} There the IRS was accused of “targeting” political organizations seeking to qualify as social welfare organizations.\textsuperscript{135} It appears though that the IRS simply did not know how to determine if an organization was intervening in a campaign for sure and how much intervention was too much.

Where an organization primarily engages in influencing elections it is then considered for tax purposes as an organization described in section 527.\textsuperscript{136} It still maintains a tax exempt status, but is subject to a tax on investment income.\textsuperscript{137} Unlike a social welfare organization,
Section 527 organizations must publicly disclose their donors. Social welfare organizations that conduct too much political campaign activity can be considered political organizations under section 527. The IRS has provided guidance as to when certain activity is considered an exempt function activity under section 527 for social welfare organizations as well as business leagues and labor unions. The analysis is similar to the assessment of when a section 501(c)(3) organization has engaged in political campaign intervention. If categorized as exempt function activity, the organization comes under the tax under section 527(f). The IRS suggests in the revenue ruling that the organization could alternatively create a segregated fund to operate as a political organization under section 527 subjects to the notice and reporting requirements of that section.

The most intense political battle about social welfare organizations is over whether they must disclose their donors. Many refer to social welfare organizations as “dark money organizations” because they need not publicly disclose their donors even though they conduct politically related activity. Additionally, though the IRS used to require the disclosure of substantial donors to the IRS itself on Schedule B to the Form 990, the IRS recently promulgated regulations that would eliminate the requirement for social welfare organizations to disclose their donors.

B. What Type of Organizations Make up the Social Welfare Organization Community

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138 Form 990, Return for Organization Exempt from Income Tax, Schedule B Schedule of Contributors Instructions.

139 This can create real problems for a social welfare organization because a § 527 organization is supposed to file a notice with the IRS within 24 hours after its formation. 26 U.S.C. § 527(i).


141 Id.


143 REG-102508-16], RIN 1545-BN28, see at the Federal Register here https://ssrn.com/abstract=3587606
The Urban Institute study of who made up social welfare organizations in 2016 provides a picture of advocacy groups within the section (c)(4) context as compared to all others. The study found that it was quite a diverse group of organizations. As of 2012, the most numerous groups were community service clubs, like Kiwanis and Rotary Club, making up 39% of total social welfare organizations. These organizations though made up only 0.8% of total revenue at a little over $700 million in revenue. Health insurance and providers were one of the smallest in numerosity, making up only 0.6% of the group, but possessed over 72.5% of the revenue at over $62 billion. A review of Form 990s filed suggests that Delta Dental affiliates around the country make up a large portion of that group. Homeowner/neighborhood community groups made up about 9.2% of the group with only about 2.8% of the revenue. Sports and recreation clubs made up about 10.1% in number and 3.9% in revenue at around $3.4 billion. A large group at 27% fit into a category of other. Khoulish suggests that advocacy organizations fit somewhere in this group. That group held 12.5% of revenue at $10.8 billion.

I also provide here some specific examples of types of social welfare organizations that I will return to again in Part IV, Analysis. I first look at advocacy related organizations. Then I look at a health related organization. Finally I consider some specific clubs and homeowner’s associations.

The National Rifle Association, which earned over $366 million in revenue in 2016 yet experienced a nearly $46 million loss is a social welfare organization. The American Civil Liberties Union, which earned over $155 million in revenue and experienced an almost $90

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144 From Camps to Campaign Funds, supra note 25. See also, Examining the Landscape supra note ___ at 360-67 (unpacking the Khoulish study and discussing it in conjunction with data from IRS Data books).

145 From Camps to Campaign Funds, supra note 25, at 6, tbl.1.

146 See the NRA’s Form 990 here https://projects.propublica.org/nonprofits/organizations/530116130.
million gain is a social welfare organization too.\footnote{See the ACLU’s Form 990 here \url{https://projects.propublica.org/nonprofits/organizations/330325795}.} The first states that it provides firearm safety, training, education and advocacy, while the latter states that it maintains and advances civil liberties such as those expressed in the First Amendment to the Constitution. Finally, Karl Rove’s organization Crossroads Grassroots Policy Strategies qualifies as a social welfare organization as well. It earned $16 million in revenue in 2016 and had a small about a half-a-million-dollars in earnings.\footnote{See Crossroads GPS Form 990 here \url{https://projects.propublica.org/nonprofits/organizations/272753378}.} It advocates for citizens on legislative issues that will shape our nation’s future. There are large and powerful democratic candidate related organizations that are exempt as social welfare organizations as well.\footnote{Many politicians including Hillary Clinton and Donald Trump have social welfare organizations that back their political efforts in some way.}

Delta Dental affiliates exist in all 50 states across the country. They operate as nonprofit organizations that qualify as tax exempt social welfare organizations. The largest, Delta Dental of California generated over $6 billion in revenue in 2017 and earned profits of approximately $150 million.\footnote{See California Delta Dental’s Form 990 here \url{https://projects.propublica.org/nonprofits/organizations/941461312}.} These organizations work to advance dental health through dental health benefits, technology and support. It’s a little mystifying that Delta Dental continues to qualify under this tax-exempt status. It’s mystifying because the IRS successfully revoked the tax exempt status of Vision Services affiliates around the country.\footnote{Vision Serv. Plan v. United States, 265 Fed. Appx. 650 (2008).} Though I discuss the law above, the primary reason Vision Services lost its status is because it operated almost exclusively to assist only its members rather than improving the community.

Kiwanis International, Inc., a social welfare organization, describes itself as “a global organization dedicated to improving the
world one child and one community at a time.” It earned about $18 million in revenue in the 2018 fiscal year, with about $1 million in investment income. Additionally it incurred about $18 million in expenses. It holds almost $35 million in assets. There are then a series of districts that make up Kiwanis International, such as the Cal-Nev-Ha District of Kiwanis International which brought in about $2.3 million in revenue and about $2.3 million in expenses in the 2018 fiscal year. Once you start getting into the club level the revenue is typically under $1 million a year. Guidestar is also filled with charitable organizations of similar sizes associated with the districts and the clubs. There are around 5,000 clubs and over 140,000 members in the United States according to Kiwanis.

Rotary International is much larger bringing in over $106 million in revenue and about $95 million in expenses in the 2018 fiscal year. It earned $11 million in investment income. It holds a total of $172 million in assets. It has a similar mission of providing service to others, “and advances world understanding, goodwill and peace through our fellowship of business, professional, and community leaders.” It has very large associated charities including the Rotary Foundation of Rotary International which holds over $1.25 billion in assets and

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153 See the Kiwanis International, Inc. website here: https://www.kiwanis.org/about/structure-of-kiwanis
156 https://www.kiwanis.org/clubs
158 Id.
brings in robust annual revenue.\textsuperscript{159} The clubs themselves appear to be relatively small business like the Kiwanis clubs though there are larger charitable foundations that seems to be attached. Rotary reports there are over 337,000 members in the United States.\textsuperscript{160}

Though many homeowners’ associations are quite small there are some large homeowners’ associations such as the Riverstone Homeowners Association, Inc. out of Sugarland, Texas. It took in about $7.8 million in revenue and almost the same in expenses in the 2017 tax year.\textsuperscript{161} They say they promote the health, safety, and welfare of their residents. It hires a management company to maintain the neighborhood. There appear to be a small number of homeowner’s associations that earn between $1 and $3 million dollars annually. But most social welfare organization homeowner’s associations are very small, like $80,000 a year found in the Deerfield Homeowner’s Association out of Fillmore, California.\textsuperscript{162}

\section*{C. Tax Consequences of Forming as a Social Welfare Organization}

A person forms a social welfare organization by first incorporating a nonprofit corporation under state law. It then files a Form 1024 with the IRS seeking to be recognized as exempt from taxation under section 501(c)(4) of the Code.\textsuperscript{163} The newly formed organization can then raise money through contributions, business operations (primarily activities that further its purpose), and perhaps loans. As long as it conducts business substantially related to its purpose its income is exempt from the federal income tax.

\begin{footnotes}
\item[160] https://www.rotary.org/en/get-involved/rotary-clubs
\item[163] 26 U.S.C. §506 (requiring social welfare organizations to file a notice with the IRS “not later than 60 days after the organization is established”). Form 1024, Application for Recognition of Exemption Under Section 501(a).
\end{footnotes}
A contributor to a social welfare organization may not deduct their contribution as a charitable contribution under section 170 of the Code. However, in addition to the possibility of deducting a contribution under another section of the Code, contributors can still obtain real tax benefits from certain contributions. A contributor who donates appreciated assets need not recognize the gain on the contribution. For instance, assume Sarah owns stock she bought for $100 that is now worth $1,000. Sarah can contribute that stock to a social welfare organization and avoid recognition of that gain inherent in that stock. This allows Sarah a deduction in effect. The social welfare organization is carrying out $1,000 of activity Sarah supports at a tax cost of only $100 worth of income to Sarah. Had she first sold the stock and contributed the cash, she would have had to pay tax on the $900 gain. By transferring the appreciated asset to a social welfare organization, she avoids income tax on $900.

A social welfare organization might owe tax if it engages in an unrelated business. This is a business activity that does not substantially further its purpose of promoting social welfare.

One further tax piece makes a social welfare organization potentially appealing to wealthy interests. While it used to be believed that a contribution to a social welfare organization was subject to the gift tax, Congress changed the law in 2016. Sarah can thus make unlimited gifts to a social welfare organization without needing to worry about the gift tax.

The bottom line is that a person who chooses to further their interests through a social welfare organization gains some tax benefits. First, they can avoid income tax on gains on appreciated assets and gift tax on any contribution. Second, no tax is owed on profits earned by

164 For instance, a contributor might be able to deduct a payment as a trade or business expense under 26 U.S.C. § 162.

165 Cf. 26 U.S.C. § 84 (makes the contribution of appreciated assets to a political organization a realization event). If Sarah were to transfer that same stock to a §527 political organization instead, she would have to pay tax on the gain.


the social welfare organization in any taxable year as long as the profits are from a related trade or business. These benefits though generally are ones that we might think of as collective benefits. William Andrews has argued that those things we consume in a collective manner probably should not be taxed to the person who so contributes. In the analysis in Part IV, I consider whether a political justice critique might shed light on this argument.

D. Conclusion

The vague legal standard required by Congress that social welfare organizations operate exclusively for a social welfare purpose has led to a hodge-podge of groups being exempted from tax. The IRS generally looks to see if it is a “community movement” or it furthers “civic benefit” or it somehow “promotes the common good.” The standard implies that the activity involved should be one shared by the community and one that benefits the community. But these decisions as to whether activities are legitimate are made by the IRS. It appears to have done its best to bring rigor to that question, but the IRS is left making calls that might otherwise be left to a congressional choice.

PART III: RATIONALES FOR TAX EXEMPTION

Congress provides for the exemption from the federal corporate income tax for most nonprofit entities in the United States. While the rationale for their exemption used to be unstudied, the matter has received increasing attention. Most of that work remains focused on

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169 See William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 Harv. L. Rev. 309 (1972) (arguing that gains incurred for collective purposes, such as in a charitable organization, ought not be taxed).


charitable organizations, but an increasing number also consider other tax-exempt entities. The initial forays contended that the exemption amounted to a *quid pro quo* in return for some collective service or good the government might have provided on its own. Others argued it made no sense to count the gains of some nonprofits like charities as income. Most theories assume instead that the corporate income tax *should* apply to all corporations. Those theorists then


172 For example, a symposium recently considered the appropriateness of the exemption of social welfare organizations. 2017 New York University’s National Center on Philanthropy and Law’s Conference, “Social Welfare Organizations: A Better Alternative to Charities?”

173 See *Federal Tax Support*, supra note __, at 45.

174 *Exemption of Nonprofit Organizations*, supra note __. They also argued a tax on charitable activity would unfairly apply the high corporate tax rate to individual consumption that ought to be taxed at a lower rate. Also, they argued it might just be inconvenient to apply a tax to organizations that do not amount to much of any economic activity. All the same, Bittker and Rahdert acknowledged many categories of exempt organizations like business associations did in fact generate taxable income.

175 *The Rationale*, supra note __. There is also a long literature considering who bears the incidence of the corporate income tax. It could be shareholders, labor, consumers, or worldwide holders of capital. For a rundown of some of the theories, see Jennifer Gravelle, *Corporate Tax Incidence: Review of General Equilibrium Estimates and Analysis*, 66 NAT. TAX J. 185 (2013).

Electronic copy available at: https://ssrn.com/abstract=3587606
view exemption as a subsidy equal to the annual tax the nonprofit would have paid in tax without the exemption.176

There are two dominant rationales: Henry Hansmann’s efficiency rationale177 and Burton Weisbrod’s government failure rationale.178 Both seem to assume that the results of a free market are the ideal ends of a well-designed tax policy.

Hansmann argues the government should subsidize those nonprofits that provide goods and services that are not produced at an efficient market level because of a market failure.179 For instance, in the case of aid to the poor in a foreign country there is a classic case of a market failure as a result of asymmetric information.180 Donors who buy the aid cannot ensure the aid arrives. We can thus expect less aid to arrive than is optimal. Because there are no owners of a nonprofit, donors can ostensibly have more confidence in nonprofits to provide these types of goods and services.181 But, the lack of owners means it’s harder to generate the necessary capital to build the operation.182 With a governmental subsidy through tax exemption, we might approach a more efficient provision of these types of goods and services. Hansmann is less sanguine about much of the rest of the exempt sector

176 For instance, Halperin makes this assumption based on the belief that the income tax should be designed to properly measure income. Mutual Nonprofits at 135.

177 The Rationale, supra note __. See also Charities a Subsidy?, supra note __ at 294-97 (adopting Hansmann’s contract failure analysis to examine charitable organizations). There are a number of scholars who contest this efficiency rationale. For instance, in Altruism in Nonprofit, Rob Atkinson argues that we subsidize charitable nonprofits to encourage altruism and to encourage redistribution of resources, 633-34. See also Daniel Shaviro, Assessing the Contract Failure Explanation for Nonprofit Organizations and Their Tax-Exempt Status, 41 N. Y. L. SCH. L. REV. 1001, 1006-1007 (1997) (arguing that Hansmann’s underinvestment hypothesis is likely wrong and that exempt organizations may also over invest in domains such that a penalty could be called for instead of a subsidy; though ultimately Shaviro argues for an efficiency rationale to support those organizations that provide some positive externality).

178 Theory of the Voluntary, supra note __.

179 The Rationale, supra note __ at 55.

180 Id. at 69-70.


182 Id. at 72.
such as social clubs because he is suspicious that there is no efficiency problem that these organizations solve and believes they can raise necessary capital.  

Weisbrod argues that tax exempt organizations provide an opportunity to solve a problem he calls “government market failure”. Because majorities rule in a democracy, there will always be some substantial minority who is unable to accomplish their governmental goals of the provision of collective goods. Tax exempt entities provide a modest governmentally financed avenue for satisfying the public good needs and wants of this minority.

What have scholars said regarding social welfare organizations? Lloyd Hitoshi Mayer argues that most social welfare organizations can be considered legitimately tax exempt because “the act of aggregating funds for the purpose of pursuing a collective, non-business (i.e., not for-profit) activity should not be subject to tax as long as any net income is either refunded to the persons supporting the activity (e.g., dues-paying members), or retained for future use that furthers the nonprofit’s purposes.” Mayer then notes that investment income and capital expenditures are problems because this is not just a pooling of nontaxable activity carried out together. He thinks many social welfare organizations should pay tax on investment income. He overall finds it a useful solution for those trying to conduct community-based activity in a tax-exempt form that do not quite meet the section 501(c)(3) standard.

Ellen Aprill notes that the universe of social welfare organizations is quite diverse. She argues there is practical reason to believe the

183 Id. at 94.
184 *Theory of the Voluntary,* supra note ___ at 22.
185 Id. at 31.
187 *A (Partial) Defense,* supra note 97, at 44.
sections broad nature serves an important purpose. It safeguards “the limits of § 501(c)(3) and to defend the integrity of § 501(c)(3),” by fulfilling a boundary protecting function. Its most important boundary keeping role might be to keep the lobbying limitation on charitable organizations constitutional. While the IRS admitted some organizations that were not quite charitable to the social welfare fold, these acts arguably provided a signal to Congress which eventually created new tax exempt categories for these organizations. In that sense it protected the boundary of charitable organizations.

Roger Colinvaux focused on social welfare advocacy organizations alone. By that he means those organizations engaged in political campaigns. He sees the ability to use social welfare organizations to intervene in campaigns and avoid campaign finance laws to be a corrupting influence on the nonprofit sector as a whole. He thinks this problematically leads to a sense that social welfare organizations are tax shelters, when in fact, to Colinvaux, they are disclosure shelters. He argues that the primary changes needed within the social welfare sphere is clarity of the law particularly with respect to political activity disclosure. He acknowledges that the IRS is probably not the best institution from which to require disclosure but thinks the harm of non-disclosure outweighs the

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190 *Id.* at 383.

191 *Id.* at 376.


193 *Id.* at 495.

194 *Id.* at 498.

195 *Id.* at 501-02.
institutional harm. He also argues that we ought to tax contributors on appreciated assets transferred to social welfare organizations.

In addition to tax policy scholarship, there is a literature from philosophy, sociology and history looking at the role of nonprofits within a democratic capitalist system. Rob Reich, for example, in his book *Just Giving* frames the question of philanthropy as: “given the ubiquity and universality of philanthropy, what attitude should a state have toward the preference of people to give money away for some prosocial or public purpose?” As currently regulated he believes the vast money in the philanthropic sector, which surely includes social welfare organizations, has become a plutocratic force. Rather than a liberal democracy, the quantity of money of wealthy interests going into philanthropy is turning us into an oligarchy because wealth is determining our social solutions for us. He argues we need a political theory of philanthropy.

Jonathan Levy, a historian, contends that nonprofits today work to “pass through” wealth, power, and rights to wealthy individuals rather than carrying out publicly minded missions. Aaron Horvath and Walter W. Powell are concerned about what they term “disruptive philanthropy.” “[I]niatives, we contend, crowd out the public sector, further reducing both its legitimacy and its efficacy, and replace civic goals with narrower concerns about efficiency and markets.” As some tax scholars believe the potential for wealthy interests to make problematic tax use of social welfare organizations at a greater level

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196 Id. (citing to Lloyd Hitoshi Mayer, *The Much Maligned 527 and Institutional Choice*, 87 B.U. L. REV. 625, 682 (2007) (arguing that the FEC rather than the IRS should be the institutional choice for monitoring disclosure).

197 Id. at 503 (citing to Gregg D. Polsky & Guy-Uriel E. Charles, *Regulating Section 527 Organizations*, 73 GEO. WASH. L. REV. 1000, 1013 n. 81 (2005) (arguing that this rule ought to apply to all exempt organizations except charitable ones).


199 Id. at 15.


201 Aaron Horvath and Walter W. Powell, *Contributory or Disruptive: Do New Forms of Philanthropy Erode Democracy?* 89, in PHILANTHROPY IN DEMOCRATIC SOCIETIES, ed. ROB REICH, CHIARA CORDELLI & LUCY BERNHOLZ (2016).
than a charitable organization, these are concerns we should have about with social welfare sector as well.

**PART IV: ANALYSIS**

This part primarily evaluates the income tax regime applicable to social welfare organizations from the perspective of political justice as described in Part II. Thus, the primary question is whether the provision of tax exemption for social welfare organizations is just because it does not harm, and maybe enhances, equal political voice. There are two primary issues here. First, what is the relationship of tax exemption for social welfare organizations to equal political voice? Second, what is the relationship of social welfare organizations to ensuring some of the essential rights to a democratic order identified in Part II(B) such as freedom of speech, association and free and fair elections?

I first consider social welfare organizations as a part of our democratic order. I then consider whether the tax treatment of social welfare organizations amounts to a subsidy. Next, I apply a political justice critique to social welfare organizations by examining three types of specific social welfare activity/organization which I mentioned above in Part II: advocacy, health services/insurance, and community clubs along with the facility of town-like services such as in the case of a homeowners’ association. I also evaluate these questions in light of Hansmann’s contract failure theory, and Weisbrod’s government failure theory. Finally, I consider broader implications of this analysis such as its impact on the rest of the sector. What might this analysis imply for the charitable sector? Finally, I suggest some implications of this political justice analysis for the rest of the Code.

**A. Social Welfare Organizations as a Part of Civil Society**

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Civil society is a long acknowledged important part of a just political system. As discussed in the Introduction and in Part II, civil society consists of associations and institutions that facilitate the formation of public opinions in spaces located outside of the for profit or governmental sectors. This includes most of the nonprofit sector and some associations outside of that. While we might question whether large business operations such as HMOs fit into civil society because of the fact that they are probably part of the economic order instead, most social welfare organizations fit within civil society. While the democratic traditions discussed in Part II (B) support civil society, they each have different takes on what role these organizations ought to play in a politically just order.

Though for somewhat different reasons, each democratic tradition finds that freedom of association, speech, information, and free and fair elections are critical to a well working and just order. Some definitions of civil society include these freedoms. This makes sense as civic associations often play a real role in protecting these freedoms. Thus, the formation of these organizations is in itself important to a democratic order and they likely work to protect that democratic order.

As discussed in Part II (B), republican theorists view civil society with mixed feelings. In part, they fear civil society associations because they express selfish interests that conflict with the general will of the state. Nevertheless, the republican thinks civil society critical to a just order. Madison warned of the problem of faction but found that government should not prohibit them. He did argue we should hinder them through political structure though. Alexis de Tocqueville thought civil society the lifeblood of democracy. Some modern


204 Three Normative Models, supra note __, at 8.

205 [Rousseau – looking for his quote about the selfish nature of associations and the conflict they raise with the state on the whole.


republicans argue non-domination by the state is an important principle and see civil society as a bulwark to protect the individual from arbitrary intervention by the state.\textsuperscript{208}

Within the liberal order, it seems civil society serves two primary functions and a fundamental one. First, politics is a battle between interests who fight for the right of their idea to be ascendant.\textsuperscript{209} Associations bring the important information to the government in that battle. Government acts as referee. Secondly, civic life is a place for individuals to take care of themselves through voluntary action.\textsuperscript{210} If a nonprofit is the best provider of a service, the state ought not stand in the way of that effort. Finally, freedom of association is a fundamental individual right in itself.

As discussed in Part II (B), the deliberative democratic theorist argues civil society’s most important role is to energetically keep open the communication structures of a broad public sphere.\textsuperscript{211} In effect the goal of associations of civil society ought to be to improve the quality, quantity, and diversity of deliberation in the public sphere. This is a different role than that conceived of by either the liberal or republican tradition, though it may be closer to republican because of its efforts to find a common will. Habermas developed his theory in part in a fear of the consequences of a republican tradition that prioritized the state. He believes that led to problematic “totalitarian societies of bureaucratic socialism.”\textsuperscript{212} Modern republican theorists who see civil society as a bulwark against the state seem to agree with this concern and analysis of deliberative democratic theory.\textsuperscript{213}

Thus, there is broad agreement that political justice as democracy includes freedom to form and operate social welfare organizations, and

\begin{footnotes}
\item[208] {\textit{Freedom and Government, supra} note __, at 148.}
\item[209] See Part II (B) at page __ and FNs __ to __.
\item[210] See Part II (B) at page __ and FNs __ to __.
\item[211] {\textit{Between Facts and Norms, supra} note __, at 369.}
\item[212] {\textit{Between Facts and Norms, supra} note __, at 369.}
\item[213] Consider, for e.g., Philip Petit {\textit{Freedom and Government, supra} note __ at 147 discussed in Part II (B) (arguing civil society is a bulwark to protect individuals from arbitrary actions of the state).}
\end{footnotes}
realistically just about any nonprofit entity. They also believe in the fundamental equality of each person and their right to an equal political voice. Part of our political justice analysis must be therefore to determine what role tax exemption plays in ensuring a freedom to form these associations. Critically though, as discussed in Part II there is a recognition that unequal resources for these groups can lead to unequal voice before the legislature.

B. Is Tax-Exemption for Social Welfare Organizations a Subsidy?

As a matter of income tax, should transfers of value into and out of a social welfare organization be subject to tax? We have generally decided that transfers of things of value in and out of a typical partnership and corporation ought to be subject to taxation.\(^{214}\) By this I mean these entities are thought to conduct business that gives rise to taxable income. Conversely, we tend to think transfers of things of value in and out of charitable organizations like a soup kitchen ought not be subject to taxation. This question matters because if there is no reason to tax the income in the first place, then we need not justify “exempting” the income from tax because there is no income to tax.

There are a few primary points at which a social welfare organization might generate income that could be subject to tax: (1) member contributions, (2) business activity, and (3) investment income.

Member contributions generally include payments like dues to a nonprofit corporation from a member of a homeowner’s association, service club, or kid’s recreational group. Should these contributions be treated as payment for services that ought to trigger income at the corporate level? Business activity would include such things as payments for medical insurance coverage at an HMO or the revenue that a skating rink or a horse racing track generates in operating that business. For tax purposes, that business activity can be considered related to the social welfare purpose or unrelated. An unrelated

\(^{214}\) See subchapter k of the Code. Though partner contributions to the organization in return for their partner share are generally not taxed. 26 U.S.C. § 721.
business is already considered taxable by law.\textsuperscript{215} Finally, investment income is the income generated in a taxable year from the portfolio of investments held by the organization. This income is generally not taxed because it is not considered unrelated business taxable income.

Tax law generally views a corporation as a separate person distinct from its contributors.\textsuperscript{216} It is not an aggregate of its contributors. Thus, transfers into and out of a corporation, including one that is nonprofit, are thought to be taxable. Nevertheless, many argue that a lot of nonprofits, including those in the social welfare category, are simply engaged in the pooling of resources on behalf of individuals to accomplish something each individual could have accomplished on her own.\textsuperscript{217}

For example, assume Bob, Sue, and Betty decide to build a swimming pool together. Assume a year ago they each paid to build a pool. Now they keep an account from which they pay annual costs. Each pays $1,000 during the year to properly maintain the pool. The maintenance includes paying someone to regularly clean the pool and ensure it is ready for use. Total actual costs of running the pool in the year including depreciation amounts to $2,700 ($900 per person). It is possible that we could think of the pool activity as a legal entity. If we did, we might say that entity earned $300 in income and ought to pay a corporate tax on $300 of income. But the tax law generally does not work in this way in such an endeavor. In effect, the tax law would treat the parties as if this activity was in their individual capacity. Bob could have paid to build and maintain a pool on his own. That he happens to enter into this activity with two other people ought not to generally change this result. Likewise, many argue that it’s reasonable to think of the activity of some nonprofits, like social welfare organizations, to be the same type of pooling activity.

\textsuperscript{215} 26 U.S.C. §511.

\textsuperscript{216} Moline Properties, Inc. v. Commissioner, 319 U.S. 436 (1943).

\textsuperscript{217} See, e.g., A (Partial) Defense, supra note __, at 470 citing Exemption of Nonprofit Organizations at 348-49 discussed in Part III.
If we accept this characterization, there is no subsidy to the organization because there is no accession to wealth that ought to be taxed. Those who argue this are likely arguing that contributions like member dues should not generate taxable income. Any surplus at the end of the year is simply an account that is maintained in common for the convenience of all members. Members are doing nothing other than buying services or goods in common and keeping track of that through a corporate entity. Thus, when a member of Kiwanis pays monthly dues to pay for a facility and a weekly lunch, there should be no additional recognition of gain at the corporate level. Each member just bought lunch and space with some other people. It is no different than Bob, Sue, and Betty’s pool operation.

Not all social welfare organizations can be described as only pooling resources. Neither homeowners’ associations nor HMOs fit this model. However, for those social welfare organizations with relatively small operations it seems relatively unobjectionable to approach the matter in this way. However, once an organization reaches some level of size it seems that this claim ought to fade away. There’s a vast difference between a couple hundred friends spending less than $500,000 over the year to meet weekly over lunch, and a multi-million-dollar business providing conference services for people around the country. This could suggest that individual Kiwanis clubs with revenue under $500,000 on an annual basis, or a similar kids sports recreation league has no income to impose a tax upon. There is no subsidy in these situations, because they should not pay tax upon such pooling activity.

However, justifying nontaxation on pooling grounds does not explain the tax-exempt treatment of business or investment income. These would be taxable in the normal income tax. A Kiwanis club that ran a bookstore or invested in the stock market to support its operations would not just be pooling resources anymore in a nontaxable way. The pooling theory also cannot explain the nontaxation of contributions of appreciated property.

Still, there is another difficulty to the primary question of whether there is a subsidy to social welfare organizations. If our purpose for applying the income tax is to adjust individual taxable burdens based on ability to pay, applying a tax to a corporate entity obscures our view
of whether we are accomplishing this goal.218 Realistically, if we do not tax individuals currently on the income of a corporate entity, we provide an opportunity for individuals to defer income tax in corporate solution, which generates tax benefits. Thus, the corporate tax at the least operates to prevent this opportunity for lowering a tax burden by shareholders deferring tax over some number of years in a nontaxable corporate entity.

Income is defined as an accession to wealth, clearly realized over which the taxpayer has clear dominion.219 This accords in part with the Haig Simons vision of income that provides the base of our U.S. theoretical conception of income.220 If the only question is whether a particular corporation as a taxpayer has an accession to wealth, that is clearly realized, over which it has dominion, a nonprofit corporation would generate income that should be taxed to the extent it is not a gift or some other amount excluded from income.

However, if the question is whether a shareholder experienced those gains, we can only see that through a diffuse filter. This problem is the same whether the entity is for-profit or nonprofit. Someone benefits from the economic activity of a corporation, even if we do not know who. In the for-profit case, there is clear ownership and the holder of the interest in the corporation has some real relationship to the corporate gains. We view pass-thru entities such as partnerships in this way. Whether the partner receives money or not, we allocate the gain to the partner.221 Similarly, in the case of a grantor trust, whether the grantor receives money or not, we allocate the income of the trust to the grantor.222

In the case of a nonprofit organization though, we might say that the controlling individuals cannot be considered to have income

218 Talk About Tax Exemption, supra note ___ (arguing that all mutual benefit organizations should be presumed to be taxable unless there is a strong policy reason for subsidizing the activity).


because they have no accession to wealth, no clearly realized income, and no dominion over that wealth. Thus, if our vision was purely of a shareholder theory of the corporate income tax, we would likely never tax nonprofit organization income.

I have argued that our assumption should be that nonprofits controlled by members to benefit members (mutual benefits) should be considered to accumulate taxable income on behalf of their members. 223 In the case of a public benefit organization, such as a charitable organization, this case is more difficult to make. If operated properly, the benefits from the operation of the organization are largely public in nature. There are no shareholder-like individuals who we might say the tax is there to impose a proper burden upon. 224 To the extent the activity truly helps those who are poor, we might even think that the corporate rate of 21% is inappropriate to apply to such individuals who likely owe at a 0% rate. There may still be reasons we should think that the entity should be taxed, such as to regulate the activity by imposing a tax to limit the power of those who control the entity, or tax the entity because that’s where money is, but the shareholder theory would not explain the reason for taxing the charity.

Where do social welfare organizations fit in this order? While there is great commonality among the organizations that fit into the mutual benefits, there is little commonality within the group that makes up social welfare organizations. The sector cannot be thought to fit into either the mutual benefit or the public benefit category.

The activity of social welfare organizations is almost by definition more private than that of charitable organizations. Social welfare organizations possess a lesser status than do charitable organizations. Most prominently, Congress grants a charitable contribution deduction to donors to a charitable organization but not to a social welfare organization. The activity conducted therein is collectively believed to be less beneficial to the public. Additionally, there are more

223 Philip T. Hackney, What We Talk About When We Talk About Tax Exemption, 33 VA TAX REV. 115 (2013).

224 See William D. Andrews, Personal Deductions in an Ideal Income Tax, 86 HARV. L. REV. 309 (1972) (arguing that gains incurred for collective purposes, such as in a charitable organization, ought not be taxed).
restrictions on charity by statute, such as limitations on political and lobbying activity than there are on social welfare organizations. As discussed above in Part II, the law contains little specifics to guide a social welfare organization in how to qualify. The charitable organization statute, though vague in nature, came with a set body of common law of charitable trusts to give immediate content to a relatively vague statute.\textsuperscript{225} With social welfare, there was no law from which we could draw the rules of what fits within that purpose.

One additional complexity is that we do not tax political organizations on their income except for investment income.\textsuperscript{226} I raise this because the advocacy organizations at least could be thought to fit into this tax-exempt category. Non taxation of political organizations was a long IRS practice.\textsuperscript{227} Congress codified Section 527 to govern their tax treatment in 1974. We may not tax this income because it is considered to be a pooling of resources. There is no deduction for contributors to political campaigns,\textsuperscript{228} and we require the payment of the income tax on a transfer of appreciated property to a political organization.\textsuperscript{229} It seems like we might choose not to tax this activity because it might be troubling by implying political campaigns are run for transactional purposes. Maybe also we don’t want to hinder political activity.

In conclusion, outside a relatively narrow pooling context, there is a good claim that exemption from income tax in the case of a social welfare organization ought to be thought of as a subsidy. There are some complicating factors to that case. However, given the general more selfish nature of social welfare organizations than charitable organizations, and that in many instances substantial businesses are

\begin{footnotesize}
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\item See, e.g., \textit{Bob Jones Univ. v. United States}, 461 U.S. 574, 598 (1983).
\item 26 U.S.C. § 527.
\item 26 U.S.C. § 162(e).
\item 26 U.S.C. § 84.
\end{enumerate}
\end{footnotesize}
operated within this sector, we ought to come up with a sufficient justification of this exemption.

C. What Does Democratic Political Justice Say About Providing a Subsidy to Social Welfare Organizations?

In this section, I first consider the implications for tax purposes from the conclusion of Part IV (A) that civic associations like social welfare organizations ought not be hindered by the state because our democratic traditions consider them an important part of civil society. This raises two broad questions: (1) Is this policy right as to advocacy organizations, and (2) Is this policy right as to organizations that provide other goods and services such as HMOs and other member-based structures? I will try to answer these two questions in the sections that follow. In this Part IV (C), however, I consider whether it’s possible that the principle of non-hindrance demands that these organizations not be taxed by the state.

Perhaps the income tax could be viewed as a penalty that hinders these organizations from forming and operating.230 I suggested a similar argument above in Part IV (B) as to political organizations.

Before examining that question, though, it is necessary to establish some of the fundamental reasons for employing as close to a comprehensive, global, and uniform tax system as we can.231 By a comprehensive system I mean one like the Haig-Simons definition that as to an individual includes their consumption plus change in wealth during the time period.232 By global, I mean one that treats all income

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230 See, e.g., DEMOCRACY AND ITS CRITICS, supra note __, at 170 (“In large democratic systems the right to form political parties and other political associations is necessary to voting equality, effective participation, enlightenment, and final control over the agenda”).

231 See, e.g., Uniform Taxation, supra note __, at 49-52 (defining the terms comprehensive, global versus schedular and uniform versus source treatment in an income tax system).

232 Id. at 46.
the same no matter the source. By uniform, I mean a tax system that applies the same rules to all income.

From an administrability perspective, it makes sense to extend the income tax to all arenas of life transactions in order to avoid gaming of the system. In other words, if there is individual consumption or accretion to wealth occurring, even if in a charitable or social welfare organization, it ought to be taxed. Additionally, because the same tax applies no matter the activity there should be no impact on market efficiency. Finally, such a system is argued to be equitable because everyone’s ability to pay is measured with the same measuring stick.

Realistically though, this idea is not achievable. A legislative body will exempt some activities. In our income tax system, for instance, though we could arguably tax a gift, Congress exempts such income from our tax system. But those exemptions should need to clear a high bar. The person who argues that a tax is a hindrance to the formation of a civil society organization as a rationale for exempting these organizations from income tax probably maybe ought to bear the burden of proof. Exemption will have real consequences to the functioning of the tax system including its efficiency, equity, and administrability.

Why might someone with political justice in mind argue that an organization of civil society ought not be taxed because these organizations should not be hindered by the state?

I suspect a traditional republican theorist would have no problem with the taxation of civil society groups. Such groups have a selfish will opposed to the general will of the state.

However, a modern

\footnotesize{233 Id. at 49.}

\footnotesize{234 Id. at 51.}

\footnotesize{235 Many contest that this ideal makes any sense at all. See Uniform Taxation, supra note __, at 46-49 (discussing some of the literature on this debate).}

\footnotesize{236 26 U.S.C. § 102.}

\footnotesize{237 See, e.g., DEMOCRACY AND ITS CRITICS, supra note __, at 289 quoting Rousseau (“All political societies are composed of other, smaller societies of different types, each of which has its interests and maxims . . . The will of these particular societies always has two relations: for the members of the association, it is a general will; for the large society, it is a private will, which is very often found to be upright in the first respect and vicious in the latter”) ON THE
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republican theorist, as discussed above in Part I (B), who believes in non-domination might contend it is important to allow some autonomous organizations outside the state to operate free from taxation. They might argue that there are some cleavages, like religious ones, that are salient enough within the state, and the interest important enough that some associations ought to be able to pour their money into their own endeavor without taxation. For instance, they might argue a religious association ought to have substantial separation from the state. To tax the religious association would be to hinder an important part of civil society. Our treatment today of churches as to its relationship to the IRS likely derives from such a political justice notion. If the IRS wants to audit a church, it must go through extraordinary procedures, and a church need not file an application for exemption, nor a tax return with the IRS.

Weisbrod arguably makes a liberal case for non-hindrance in his government failure theory. As discussed above in Part III, he assumes the government provides collective market goods desired mostly by the median voter. Tax exemption then allows minority voters to provide collective goods to cater to their interests. Though Weisbrod suggests we might subsidize this activity to get the efficient provision of the good, the liberal theorist might argue that we should not hinder this particular market activity. It is also consistent with the idea that we ought to let individuals voluntarily provide goods and services to themselves as much as possible.


238 This could be seen in a sense as a light version of a consociational democratic order. See Democracy and Its Critics, supra note __, at 256-58 (describing consociationalism).

239 Evelyn Brody argued we provide exemption to charitable organizations based on a sovereignty theory. Of Sovereignty and Subsidy, supra note __.


243 See discussion in Part III citing Theory of the Voluntary, supra note __.
It’s hard to know what a deliberative democratic theorist might argue. Civil society is supposed to be separate and independent from both the state and the economic forces of society. At the same time there is a need to work to bring forth everyone’s voice in an equal manner. Non-hindrance might therefore appear to make some sense to strengthen that sector. However, my expectation is that the value equal political voice would override this notion. What are the problems from a political justice standpoint of this principle of non-hindrance? The first difficulty is that if there is income in the civil society organization in its Haig-Simon sense, the nontaxation is actual support. For instance, the failure to tax investment income would be to provide economic support to such activity to the extent of the tax rate times the income. In this sense, the political justice of this rationale seems problematic.

What are the problems from a political justice standpoint of this principle of non-hindrance? The first difficulty is that if there is income in the civil society organization in its Haig-Simon sense, the nontaxation is state support. For instance, the failure to tax investment income would be to provide economic support to such activity to the extent of the tax rate times the income. The same for any business related income. In this sense, the political justice of this rationale seems problematic. Why?

First, because of the vague social welfare standard context, this policy is highly arbitrary. It depends upon a market mechanism in that those individuals who happen to have resources and a particular good or service they want to provide can provide that thing with governmental benefit, while those without the necessary resources will get no such help from the state. Additionally, to the extent the activity was in the nature of an interest group, the unequal provision of a subsidy to organizations based on their success in the market should offend the need for equality to all individuals. In other words, non-hindrance by not taxing is support of some to the exclusion of other interests.

If I am right, that most of the democratic traditions would value equal political voice the most, then the democratic traditions would support only a narrow vision of non-hindrance. If that is so, then the social welfare standard is far to vague and broad to pass the
requirements of political justice. The recognition of our shared endeavor as part of the state and the necessary belief in equality of citizens would build a strong presumption against such a provision.

D. Advocacy Organizations

By advocacy organizations I intend to mean those that lobby, are considered to intervene in a political campaign, and those that broadly advocate for a cause through education or legal processes. What does a political justice analysis suggest regarding the tax treatment associated with the advocacy organizations of the social welfare sector. For ease of analysis, in this section I look at the three specific advocacy organizations I describe above in Part II (B).

Based on social science research on the problem of collective action, I argued tax-exemption provided a subsidy in both an inefficient manner and a politically unjust way to tax exempt business leagues and labor unions. Rather than enhancing equal political voice, this system exacerbates the democratically problematic inequality of resources. Congress provides a subsidy to groups with an already strong political voice, and little to none to those with little political voice. We could enhance efficiency and political justice to end the exemption for both. However, given the weak political voice of labor, and the generally strong political voice of business, we could enhance efficiency and political justice by ending the business interest exemption and maintaining the exemption for labor unions.

Does the provision of any of these activities increase the number of people able to express their will to the government? In the case of clear partisan organizations typified by Crossroads GPS, described above in Part II (B), it seems that the only thing exemption does is amplify the voice of the politically strong. A democratic political justice theory thus would likely have to find against the provision of the subsidy through tax exemption. Its design violates equal political voice. That should be the case even in the instance of the liberal democratic theorist that supports a market model, as a result of the harm to equality of voice. Though the liberal believes in the work of

244 Taxing the Unheavenly, supra note __, and Prop up the Heavenly, supra note __.
245 Prop up the Heavenly, supra note __.
market forces, they also believe in the sanctity of equal political voice. There are likely some social welfare organizations that advance interests that experience tremendous collective action challenges. Nevertheless, because the system is predominately accessible by those advocacy organizations that do not face these challenges, elimination of the subsidy seems like the only way to make the system more neutral as a political voice equality matter.

What about more broadly defined rights organizations like the NRA and ACLU? The NRA and ACLU discussed above in Part II broadly promote the interests of a very large segment of society. They both tend to align with either the Democratic or Republican party, but they also provide information on, and defend the rights of, citizens on matters of civil liberty. Some may strongly disagree with the right to guns as defended by the NRA, but at least on its face under any of the three traditions it is a matter that citizens might discuss and agree or disagree upon as a fundamental right. The rights defended by the ACLU though represent core liberal rights, discussed above in Part I (B), that make a real part of each democratic tradition.

These organizations are both in their own way trying to defend what we perceive to be civil liberties here in the United States. Do these organizations as fashioned increase the political voice equality or defend liberal rights? Or, like the analysis of the partisan organizations, do they perhaps drown out those who would otherwise speak?

With the ACLU it seems it directly protects the civil liberties that are specifically critical to political voice equality such as freedom of speech and association. It’s doubtful there could be a more deserving organization on this front. The republican and liberal theorist I think would find the worthiness of this organization. The deliberative democracy theorist would as well.

The NRA seems more complex. I personally have difficulty with the goal of the NRA and as such hate to have my own biases play a role in the analysis. But, the protection of gun rights does not seem to go to typical civil liberties that might enhance the social choice function at all. As we saw in the contract and government failure analysis, it seems much more mixed in its goals. The NRA likely has mixed motives: protecting the interests of the business of making and
selling guns and protecting gun owner rights and educating about the use of guns. On the one hand, the first interest describes an organization in the nature of a business league that I have previously argued does not deserve exemption. On the other hand, the right to bear arms could be something we collectively agree ought to be supported. Arguably the founders made such a conclusion in the Constitution in the Second Amendment.

It might be useful to consider the application of Hansmann’s contract failure theory. As to the NRA, we might find that the market was already providing gun education without any subsidy. Furthermore, gun manufacturers and distributors have a strong interest in advocating for the rights of gun owners. Under contract failure then, we might say that such an activity should not qualify because there is no contract failure. By providing a subsidy, we make the market inefficient.

With respect to the ACLU, however, it’s unlikely the market would provide these services. Lawyers provide these services to clients with means in some small bit, but it’s unlikely they generate enough private clients to provide the services of the ACLU. Thus, conversely, we might find that the ACLU would be the type of organization that should be granted the status of exemption to benefit from a subsidy.

How about partisan organizations, such as Crossroads GPS? If we think of these organizations as providing the service of advocating for a cause, there is no market inefficiency. Plenty of for-profit companies are willing to offer such services. If we abstract out to the rights represented instead, perhaps there is a contract failure involved. Those groups advocating for establishment candidates and causes likely face little collective action challenges, while non-established candidates and causes may face enormous challenge. As I discussed in Taxing the Unheavenly Chorus, certain groups likely face little challenge in organizing.246 Wealthy interests for instance will face little difficulty organizing themselves.247 Because it’s likely that the same wealthy and small groups are the ones taking advantage of the social welfare exemption, contract failure would likely find against the exemption of

246 Taxing the Unheavenly, supra note __, at __.
247 Taxing the Unheavenly, supra note __, at __.
these organizations. The question we are left with is whether we could
design an exemption system targeted only to those that face great
collective action challenges. I don’t believe we could develop such an
administrable system.\textsuperscript{248}

What about government failure? Can we justify exemption to
advocacy social welfare organizations because these organizations
provide governmental services that a minority desires? This idea does
not fit perfectly because advocacy organizations like Crossroads GPS
do not primarily provide what we traditionally think of as end goods
or services. They are instead seeking such end goods and services from
the government. Maybe we could envision advocacy organizations as
providers of information to the state. But, the unequal provision of the
subsidy to those who need it least under efficiency or political justice
would seem to outweigh any value associated with this provision.

The government failure idea has more promise in services provided
by organizations like the ACLU and the NRA. The ACLU provides a
service by representing people in court to protect their civil liberties.
The NRA provides gun safety education and protect rights of gun
owners. Thus, again maybe we find some support for some narrow
areas of advocacy organizations that protect civil rights at an
individual level.

Where does this leave us on tax exemption? If we are to grant tax
exemption to advocacy organizations, it should be highly conscripted
to only those who are clearly providing protections to civil liberties
like that provided by the ACLU. The case for the ACLU seems
particularly strong under the political justice analysis. Congress could
amend the statute to clarify that the only advocacy type organizations
permitted are those actively protecting the civil liberties of the people
in the United States.

However, this is likely a difficult political line to hold. Partisan
groups would likely protest at being left out while groups like the
ACLU were permitted. For that reason I would broadly recommend
-ending tax exemption for all advocacy related organizations. It would
therefore probably be strategically better to simply end exemption for

\textsuperscript{248} Perhaps that we exempt labor unions suggests we could come up with other similar
categories that face significant collective action challenges.
these organizations. It seems likely that the value of eliminating exemption altogether for these groups is greater than the modest loss of incentives to civil liberty protecting organizations.

Finally, if advocacy related social welfare organizations were simply taxable corporations, there are two losses. We might lose publicly disclosed information about these organizations in the annual tax returns they file. But, such a task would be better handled by an organization like the FEC. Secondly, many charitable organizations form advocacy organizations to get around the limitations on lobbying and political campaign intervention.\footnote{249} Arguably the ability of charitable organizations to operate a social welfare organization to speak politically has made those limitations on speech constitutional.\footnote{250} This presents a significant practical problem to this analysis, but I don’t think it changes the fact that the operation of the system is politically unjust.

E. Health Service and Insurance

What about health service and insurance? We could likely improve social welfare by providing more dental insurance for Americans, particularly poor children and the elderly. According to some statistics, approximately 77 percent of Americans had dental health insurance in 2016.\footnote{251} Those without dental insurance tend to receive less dental care and in turn have more health issues from heart disease, to osteoporosis and diabetes.\footnote{252}

Arguably a political justice analysis would find tax exemption here as designed problematic. By as designed I mean the vague standard

\footnote{249} 26 U.S.C. § 501(c)(3).

\footnote{250} Regan v. Taxation with Representation, 461 U.S. 560 (1983) J. Blackmun concurring (arguing that the restrictions on lobbying and election activity passed constitutional muster because the IRS administered the law to allow people involved with the operation to form social welfare organization and PACs to speak).


that provides little clarity on that which is permitted. Tax exemption provides a subsidy to individuals to seek collective services outside of a collective decision-making process. By this I mean that the way we provide health services is a matter that impacts us all. As such, we each should have a say in how that service will be provided. But, with social welfare health service organizations, only the individuals who control the group, likely the managers of the company, get a vote on how the services will be provided. This violates equal political voice. It allows groups that have the capacity to organize to do so and receive a subsidy from the government with little in the way of government directed limits. Thus, a political justice analysis does not support allowing tax exemption in the case of the provision of most health care services.

A contract failure analysis may ultimately be the beginning and end of the analysis of whether health insurance should be provided in a tax-exempt structure. Delta Dental, discussed above in Part II (B) seems to be doing fine selling dental insurance. It is unlikely to face any challenges in generating the funds it needs to operate its business through borrowing or through customer generation. It is carrying out an activity that is broadly carried out in a taxable for-profit manner to a public who pays the price associated with the activity. Though there appears to be a real crisis of lack of access to dental care, there is no indication that the tax rules or a tax subsidy do anything to help in this regard.

A government failure analysis is not particularly enlightening. Though there is a dearth of dental services for the poor and the elderly, the social welfare rules are not designed to ensure these needs are met. Also, it is odd to think of dental insurance as some minority voter desired service as Weisbrod’s proposed in his theory. Dental insurance would seem to be desired by all. There is surely no civil liberty interest protected here.

Someone might argue that if an organization is objectively carrying out something that Congress, our representative body, has determined is objectively a legitimate activity to help the broader community, then a subsidy in such a situation could not possibly be offensive to the notion of social choice. Here, as mentioned above, there is a real crisis of lack of access to dental care. The problem with this case is that it
ignores the fact that this grants a large swath of individuals public money to carry out activities that arguably ought to be subject to the equal decision of all. This could I think be corrected by Congress enacting rules on dental and vision care that ensure they meet real collective interest needs rather than just letting the IRS sort things out.

To provide this exemption in the case of healthcare is to support a transactional pluralism. By transactional pluralism, I mean a vision of governance that intends to give honor to groups helping to make collective decisions to benefit democracy, but instead allows the market to make collective decisions on the public’s behalf. We likely think of these market-based systems as akin to a voting mechanism where the “market decides” through democratic votes. But these systems are far from voting systems and instead reward individuals with government aid based on their money and success in the market rather than operating as real democratic decision making.

F. Community Clubs/Homeowner’s Associations

Finally, a look at community clubs like Kiwanis and Rotary, and the provision of tax exemption to homeowners’ associations.

Both service clubs and homeowner’s associations seem like activities for which there is potential contract failure. It is difficult to organize large groups of neighbors into associations that will benefit a broad segment of land. The key to that is large and the broad benefit not focused on individual homeowners. It is additionally likely difficult to maintain community clubs that are focused on service rather than primarily about social mingling, in the way section 501(c)(7) social clubs work. In a government failure sense, also, it seems quite possible that large homeowners’ associations providing all people the provision of streets and parking fits into the idea of allowing smaller groups of individuals to come up with a broad-based governmental solution to a community problem.

What does political justice have to say about these types of organizations? Given that these organizations are likely playing little role in advocacy at the broad governmental level there is no reason to believe they might in an advocacy sense use money to drown out other interests at the governmental level. However, it is possible that these organizations are operating at a local level in ways that are harmful to the democratic nature of the larger municipality. For instance, some of
these associations may be providing security primarily to the immediate neighborhood in a way that is not available and causes harm to other areas. More study would be needed to understand the total impact.

Community clubs likely assist in generating and disseminating information on broad important topics in ways that again do not interfere with the generation and dissemination of information at the governmental level and thus likely are important to popular will. Assuming a homeowner’s association is genuinely open to the broader community and not substantially providing services to individual homeowners, it seems that there is little likelihood that these associations will harm popular will and may even enhance it in part. As long as these clubs and associations stay relatively small on a revenue and assets basis, as it appears they do, and are genuinely open to the larger community in which they sit, maintaining tax exemption is probably inoffensive. Ideally, they ought to be highly democratic in nature.

We might be modestly bothered by the lack of the larger community to have the right to vote on activities of a homeowner’s association that exemption would theoretically provide support to through exemption. But generally, we are likely talking about low levels of dollars with respect to both community clubs and homeowner’s associations. Thus, from a perspective of contract failure, government failure and social choice function analysis, it seems these organizations might genuinely deserve exemption assuming the IRS applies appropriate rules. It may also be wise to limit the size in revenue and assets of these groups. Once they get to large, they may no longer be serving the same type of purpose that they serve as smaller units.

G. IRS as the Arbiter of Legitimate Public Activity Harms Us and the IRS

As discussed in Part I (B), one of the principles of a well-functioning democracy and of social justice is that justice be publicly seen. People must be seen to be equally treated, and the government
must be operated in a transparent matter.\textsuperscript{253} Placing a choice that could be a collective one into the hands of IRS agents might be seen to violate that principle. It takes away the equal treatment of each citizen by removing from them their choice and supplants that choice with the choice of the IRS. Additionally, that choice made by the IRS is not a transparent one. Because of the protection of taxpayer privacy\textsuperscript{254} much that goes into the IRS decision is kept from public view. Thus, this one structural choice where Congress allows the IRS to be the arbiter of the standard of which organization furthers “social welfare” at once challenges the idea of equal treatment and transparency.

The recent concern over the Tea Party matter highlights this difficulty of the IRS involvement with this activity. Perhaps this issue could be overcome by bringing some citizen group in like a jury to make the choices over whether organizations qualify, but simply providing another mechanism to make this choice would not cure the problem. Because of the lack of the ability of the IRS to be fully transparent with the public about who qualifies, the IRS cannot appear to publicly do justice on a highly important social justice matter. This could be partially corrected through greater IRS transparency and Congress drawing sharper lines in the social welfare organizations space. Nevertheless, because the IRS can be seen to take a collective decision away from the public, as the law is currently constructed it would remain problematic. The greater clarity in rules would create a much greater sense of justice all the same.

Most concerning though, is that in forcing the IRS to make these calls of whether citizen collective activity promotes “social welfare” or not, pollutes its other activities of being seen to fairly and impartially collect the revenue for the country.

This is not an argument that administrative bureaucrats and experts cannot engage in rulemaking. They can and indeed should. However, I think the nature of this particular call is so related to our sense of political justice and a matter that ought to be left to the people and their representatives that the IRS involvement in this matter puts the IRS in

\textsuperscript{253} \textit{See supra} Part I, Section B.

\textsuperscript{254} 26 U.S.C. §§ 6103 & 6104.
a bad position as to a matter of justice. It might be possible for this arrangement to work for an agency whose purpose was solely this matter of determining the goodness of the activity of nonprofits. However, because the IRS has a primary purpose of collecting revenue, a primary purpose that requires of that agency to be perceived as just in fact, the entanglement of the IRS in this fraught matter makes this side purpose highly problematic.

H. Assuming Social Welfare Organizations Maintain Exemption, What Ought We to do, Keeping Political Justice in Mind?

There are a number of changes that could be made to the social welfare organization world generally to improve the political justice situation without withdrawing tax exemption altogether.

First, Congress should enact more detailed rules on what these organizations ought to do. Such Congressional deliberation would help to give greater legitimacy to the actions of the IRS in this fraught sphere. For instance, it is absurd to put HMOs and the IRS in the position of having to determine whether health insurance related operations ought to receive tax exemption. Congress already provides significant requirements for insurers under the Affordable Care Act, so it is hard to know how an HMO might fit some space that might be particularly needed by our community as a social welfare matter. Congress could enact rules for an HMO to qualify, or, better yet, it could decide to eliminate the HMO from this sphere altogether. Either choice would bring greater legitimacy to the IRS as it administers this section.

Additionally, taking a cue from deliberative democracy, Congress could include rules to make social welfare organizations emblems of a civil society that creates a healthy and effective public sphere. Under a political justice conception, an organization like the ACLU, by vociferously protecting liberal rights, fulfills that role. The

255 I recognize leaving matters to popular will without rules suggesting some protection for minority rights may seem uncomfortable to some. Though here, I am only suggesting not giving subsidy to primarily majority interests. Thus, this move actually ought to enhance minority interests rather than the other way around.
key is these organizations ought either exemplify equality of citizens or protect liberal rights. This would mean that rules should be designed to enhance the deliberative and inclusive nature of social welfare organizations. Rather than allowing these organizations to focus their efforts on promoting a particular idea before Congress in a rhetorical fashion, perhaps there could be an emphasis on truly educating Congress. Each organization might have to always consider and present in genuine fashion other approaches to an issue. They could be a genuine devil’s advocate to their own proposal.

The difficulty with such an effort is there is no simple language here to make such rules and is almost surely impractical. They may also prove harmful to minority interests by forcing their organizations to engage and include majority interests that despise their particular way of life. These types of challenges make me think it better overall to end exemption instead.

Finally, given the clearly greater selfish nature of social welfare organizations than charitable ones, Congress ought to change a few tax matters. Social welfare organizations should have to pay an investment income tax. Most scholars today make this claim and it is the right thing to do for equality of voice. Additionally, and in the same vein, Congress should also require a taxpayer to recognize gain on appreciated assets transferred to a social welfare organization. These two actions would go a long way to equalizing any issues associated with nonprofits. Finally, a gift to a social welfare organization should be subject to the gift tax as well.

**PART V: CONCLUSION**

Though political justice analysis does not provide all the tools to answer questions of the rationale of tax exemption, it seems that it does enhance the analysis when combined with the efficiency analysis of contract failure and government failure utilized in the tax-exempt space. It seems worthwhile to consider its application to charitable organizations and other nonprofits. It suggests that much of the field of social welfare organizations including advocacy organizations and health insurance organizations would be best as taxable entities rather than tax exempt. However, it seems to provide some support for smaller truly community based open organizations. And, it may justify
exemption in the case of a true civil liberty defending organization such as the ACLU. Nevertheless, politically this is likely a difficult line to hold. In any case, reducing the number of organizations that fit into this category and making them taxable would likely improve the function of the IRS and its perception as a fair organization by removing from its jurisdiction the necessity to make toxic political calls.