UNIVERSITÀ CATTOLICA del Sacro Cuore

CRC - CENTRO RICERCHE SULLA COOPERAZIONE E SUL NONPROFIT

WORKING PAPER N. 10

Regulation and the autonomy of foundations: a comparative analysis of the Italian and U.S. Patterns

Raffaella Rametta

V&P VITA E PENSIERO

Università Cattolica del Sacro Cuore

CRC - CENTRO RICERCHE SULLA COOPERAZIONE
E SUL NONPROFIT

WORKING PAPER N. 10

Regulation and the autonomy of foundations: a comparative analysis of the Italian and U.S. Patterns

Raffaella Rametta

V&P VITA E PENSIERO

Raffaella Rametta, LUISS "Guido Carli" University, Department of Law (Rome, Italy)

rrametta@luiss.it

coop.ricerche@unicatt.it

www.vitaepensiero.it

All rights reserved. Photocopies for personal use of the reader, not exceeding 15% of each volume, may be made under the payment of a copying fee to the SIAE, in accordance with the provisions of the law n. 633 of 22 april 1941 (art. 68, par. 4 and 5). Reproductions which are not intended for personal use may be only made with the written permission of CLEARedi, Centro Licenze e Autorizzazioni per le Riproduzioni Editoriali, Corso di Porta Romana 108, 20122 Milano, e-mail: autorizzazioni@clearedi.org, web site www.clearedi.org.

Le fotocopie per uso personale del lettore possono essere effettuate nei limiti del 15% di ciascun volume dietro pagamento alla SIAE del compenso previsto dall'art. 68, commi 4 e 5, della legge 22 aprile 1941 n. 633.
Le fotocopie effettuate per finalità di carattere professionale, economico o commerciale o comunque per uso diverso da quello personale possono essere effettuate a seguito di specifica autorizzazione rilasciata da CLEARedi, Centro Licenze e Autorizzazioni per le Riproduzioni Editoriali, Corso di Porta Romana 108, 20122 Milano, e-mail: autorizzazioni@clearedi.org e sito web www.clearedi.org

© 2013 Raffaella Rametta
ISBN 978-88-343-2549-0

Research support was provided by a grant from the Centro di Ricerca per il diritto d'impresa (CERADI), LUISS "Guido Carli" University.
Earlier versions of this article have been presented and discussed at the Third Workshop on Foundations, Dipartimento di Scienze Economico-Sociali e Matematico-Statistiche of the University of Torino and Centro di Ricerche sulla Cooperazione e il Nonprofit of the Catholic University of Milano, June 27–28, 2011 and at the 10th International Conference of the International Society for Third-Sector Research (ISTR), July 10–13, 2012. I thank Dario Casalini, Henry Hansmann, Mark Sidel, and James Allen Smith for their helpful comments and suggestions on earlier drafts. All errors are my own.

INDICE

1 – Issue at stake in the Italian legal pattern for foundations pag. 5

2 – U.S. pattern in a comparative perspective 13

3 – This article's aims 17

4 – U.S. foundations and law 19

5 – Accountability *vs.* control 24

6 – Search for a rationale 27

7 – U.S. foundations and self-regulation 32

8 – Conclusions 37

Abstract

The recent renaissance of the Italian foundation sector, while bridging the twentieth-century gaps with a philanthropic tradition rooted in the piae causae institutions, is causing lawmakers to face new challenges that are rather familiar within the U.S. pattern for private foundations. The effectiveness of the constitutional principle of "horizontal subsidiarity," is at stake, propelling a shift from state control over foundations toward freedom for foundations and their accountability to society. The U.S. pattern, instead, stems from a long-established partnership between private philanthropy and the state. Yet, no issues are more critical than nonprofit autonomy and public accountability. With the aim of providing guidance for the next reform of Italian nonprofit law, the article explores the impact of federal and state laws throughout the life of U.S. foundations, with a focus on the essential features linking the earliest stages of regulation with the latest proposals for change. Crucially, the recent trends that have developed in both patterns converge around a growing reliance on tax law as a vehicle for regulating and monitoring foundations, as well as for strengthening best practices by the sector. The article argues that although such trends raise concerns, they are not only driven by economic incentives but also are consistent with basic rationales for the regulation of foundations. That is, in return for tax exemption and advantages that foundations receive from society, they should be held accountable. While hardly new to the U.S. pattern, embracing Andrews's idea and its fundamental premises would be a crucial step toward addressing the "horizontal subsidiarity" challenge and, ultimately, enabling the rise of an Italian "law market" for charitable giving.

JEL codes: K20, L31.
Keywords: philanthropic foundations, horizontal subsidiarity, freedom, tax-exemption, accountability.

1. Issue at stake in the Italian legal pattern for foundations

During recent times, substantial changes in the Italian foundation sector and legal framework (Barbetta, 2011) have begun to bridge the historical gap between the Italian and U.S. patterns for the regulation of private philanthropy, causing, crucially, the former to face new challenges that are rather well known to the latter.

From an *empirical* perspective, data show increasing growth in the size of the Italian foundation sector as of the 1990s. According to the latest survey conducted by the Italian National Institute of Statistics (hereinafter, ISTAT), the number of foundations active in Italy as on December 31, 2005 totaled 4,720—encompassing 2,338 *operating* foundations (49.5%), 943 *grant-making* foundations (20.0%), and 1,439 *mixed* foundations (30.5%)—with an increase of 57% since 1999 (ISTAT, 2009). Of these, 46.2% operated in the field of philanthropy; 33.9% in education and research; 30.3% in cultural, sport, and recreational activities; and 21.6% in welfare assistance. These sectors of activities were followed by religion, economic development and social cohesion, health, international cooperation, environment, civil rights defense and political activity, and others ((ISTAT, 2009).

In economic terms, the total revenues of foundations surveyed by ISTAT in 2005 amounted to 15.6 billion Euros; the total expenditure amounted to 11.5 billion Euros; and the total assets amounted to 85.441 billion Euros, although the circumstances varied widely in

terms of geographical factors, types of foundations, and sectors of activity. In particular, the assets held by the 88 foundations of banking origin accounted for a large part of the total assets of the foundation sector. Indeed, close to the majority of Italian foundations had small dimensions (i.e., with total assets less than 500,000 Euros), with only 16.4% reporting endowments equal to or more than 5 million Euros (ISTAT, 2009).

Significantly, 54.6% of the foundations active in Italy in 2005 were established between 1996 and 2005 (ISTAT, 2009). Such data should be linked with the legislative use of the foundation form as a vehicle for privatizing numerous public sector organizations over the last decades.[1] The entry of *grant-making* foundations (until then, practically non-existent in Italy), which originated from the transformation of pledge and savings banks under the banking reform laws of the 1990s (Barbetta, 2008), is the most salient outcome of this phenomenon, with the largest of them currently ranking among the world's top foundations (e.g. the Cariplo Foundation).[2]

---

[1] *See infra*.

[2] According to the latest data reported by the Association of Italian Foundations and Savings Banks (ACRI, 2011), there are eighty-eight foundations of banking origin—varying widely in terms of size and scope of operations—which engage solely in socially oriented and economic development undertakings. On Dec. 31, 2010, the book value of their net assets amounted to approximately 50.16 billion Euros. The five largest foundations (accounting for 49% of the total net assets) are Fondazione Cariplo, Compagnia di San Paolo, Fondazione Monte dei Paschi di Siena, Fondazione Cassa di Risparmio di Verona Vicenza Belluno e Ancona, and Fondazione Cassa di Risparmio di Torino. In 2010, the foundations of banking origin had ordinary revenues and gains of 1,986.3 million Euros. As philanthropic entities, in the same year the foundations provided 1,366.6 million Euros in grants: most of these went to

Even from a *legal* perspective, the Italian pattern has changed dramatically, along with the fluctuating trends developed in the European context (Anheier, 2001) that led, ultimately, to the 2012 Proposal for a Regulation on the Statute for a European Foundation (Hopt et al., 2009).[3] Indeed, until the beginning of the 1990s, the Italian legal framework for foundations comprised a few general provisions set forth in the Civil Code of 1942, specifically under Book I, Title II, which is titled "legal persons." Herein, Section II outlines the substantive rules governing the two legal forms of *nonprofit* entities: *associations* (i.e., nonprofit legal persons with membership) and *foundations*, traditionally defined as assets devoted to a purpose (Galgano, 1969).

Within the original framework, discretionary governmental control influenced the creation, activities, and dissolution of foundations (Ministero di Grazia e Giustizia, 1936). In that respect, the Civil Code's regime imported an enlightenment-derived mistrust toward mortmain risks and political diffidence toward intermediate social bodies, which caused the irrevocable decline of foundations in Italy (Barbetta and Demarie, 2001), notwithstanding a long-established philanthropic tradition dating back to the *causae piae* charitable institutions (Giorgi, 1901).

---

the "art, cultural activities, and heritage" sector, followed by the "social assistance"; "research"; "education, learning, and training"; "voluntary activities, philanthropy, and charity"; "local development"; "public health"; and others sectors.

[3] COM/2012/35 final, 2012/0022 (APP).

By the end of the 1990s, the original framework for Italian foundations went through a series of major reforms (Ponzanelli, 2000). First, the Law of May 15, 1997, No. 127 repealed article 17 of the Civil Code, which subjected the validity of all real property acquisitions and acceptance of gifts by private legal persons to governmental authorization. Thereafter, the Presidential Decree of February 10, 2000, No. 361, replaced the governmental license of legal personality prescribed by the prior law with a simplified procedure that resembles the registration system of for-profit entities. Thus, presently, any foundation pursuing a lawful, possible purpose and possessing an adequate endowment[4] may obtain a legal personality and enjoy limited liability for its board members by enrolling in a legal entity register.[5] As a result, the liberalization of foundations' purposes and the consequent reshaping of the foundation form as a vehicle for achieving a wide range of aims came to challenge the political rationales behind governmental interference in foundations' activities (Cafaggi, 2000).

Meanwhile, parallel changes in the fiscal framework gradually broke up the *not* particularly beneficial treatment that Italian foundations and, broadly, nonprofit organizations have received traditionally in

[4] Practically, the amount of 100,000 Euros is regarded as a reasonable amount for a foundation operating nationwide.

[5] The legal entity register is kept under the direct oversight of either the so-called "prefetture" (for foundations acting nationwide) or the regional administrations (for foundations operating in certain fields that fall within the legislative regional competence and acting in a single region).

terms of both income tax exemption[6] and deductibility of charitable contributions. In particular, as of the 1990s a heterogeneous set of fiscal measures—e.g., laws on non-governmental organizations[7], volunteer organizations[8], social cooperatives[9], and associations of social promotion[10], up to the overarching regulations on non-commercial bodies and nonprofit organizations of social utility (ONLUS)[11] and social enterprises[12]—was aimed at promoting, through various tax benefits, the carrying out of *public benefit* activities under the *non-distribution constraint*, mostly regardless of the entities' legal form (i.e., either association, committee, foundation, company, cooperative, or other recognized and unrecognized civil society organizations). Further steps related to the tax treatment of donors have been taken in recent years for encouraging charitable giving.[13]

Beyond these reforms, in recent decades the privatization of formerly state-controlled bodies has led to the proliferation of special laws that provide for the creation of different types of foundations. These in-

---

[6] See arts. 87 and 143 of the Presidential Decree of Dec. 22, 1986, No. 917; art. 6 of Presidential Decree of Sept. 29, 1973, No. 601; art. 7 of Legislative Decree of Dec. 30, 1992, No. 504; art. 3 of Legislative Decree of Dec. 31, 1990, No. 346; art. 4 of the Presidential Decree of Oct. 26, 1972, No. 633.
[7] Law of Feb. 26, 1987, No. 49.
[8] Law of Aug. 11, 1991, No. 266.
[9] Law of Nov. 8, 1991, No. 381.
[10] Law of Dec. 7, 2000, No. 383.
[11] Legislative Decree of Dec. 4, 1997, No. 460.
[12] Legislative Decree of March 24, 2006, No. 155.
[13] Art. 14 of the Law of May 14, 2005, No. 35 (converted into the Law of May 14, 2005, No. 80) has allowed income tax deductibility of donations to nonprofit organizations of social utility (ONLUS) for an amount not exceeding 10% of the total declared income and up to 70,000 Euros per year).

clude foundations of banking origin,[14] music foundations,[15] cultural foundations,[16] university foundations,[17] and privatized public charitable institutions.[18] In this movement toward privatization, the search for innovative and efficient means of service provision to the public also led to the development of new models such as the so-called "fondazioni di partecipazione": within such models, the foundation form serves as a tool for running social or cultural activities or managing museum collections under public ownership, taking advantage of both a private law regime and partnerships with public and private entities.[19]

[14] Law of July 30, 1990, No. 218; Law of Dec. 23, 1998, No. 461; and Legislative Decree of May 17, 1999, No. 153.

[15] Legislative Decree of June 29, 1996, No. 367; Legislative Decree of Apr. 23, 1998, No. 134; Law of Nov. 24, 2000, No. 345 (converted into Law of Jan. 26, 2001, No. 6). E.g., the Fondazione Teatro alla Scala of Milano, the Fondazione Teatro dell'Opera of Roma, the Fondazione Teatro Massimo of Palermo, and the Fondazione Accademia Nazionale di Santa Cecilia.

[16] E.g., the Fondazione La Biennale di Venezia (Legislative Decree of Jan. 29, 1998, No. 19; Legislative Decree of Jan. 8, 2004, No. 1); the Fondazione Istituto Nazionale del Dramma Antico (Legislative Decree of Jan. 29, 1998, No. 20); the Fondazione Museo Nazionale della Scienza e della Tecnologia Leonardo da Vinci (art. 4 of Legislative Decree of July 20, 1999, No. 258); and the Fondazione La Triennale di Milano (Legislative Decree of July 20, 1999, No. 273).

[17] Art. 59, para. 3 of the Law of Dec. 23, 2000, No. 388 (implemented by Presidential Decree of May 24, 2001, No. 254). E.g., the Fondazione Politecnico di Milano, the Fondazione Universita' IULM of Milano, the Fondazione Universitaria Marco Biagi, the Fondazione Universita' Gabriele d'Annunzio. the Fondazione Universita' degli Studi di Teramo, and the Fondazione dell'Universita' degli Studi dell'Aquila.

[18] So-called IPABs (*istituzioni pubbliche di assistenza e beneficienza*). Art. 10 of Law No. 328 of 2000 and arts. 16-18 of Legislative Decree of May 4, 2001, No. 207.

[19] Art. 10 of Legislative Decree of Oct. 20, 1998, No. 368 (implemented by the Ministry of Cultural Heritage and Activities Decree of Nov. 27, 2001, No. 491); art. 115 of Legislative Decree of Jan. 22, 2004, No. 41; and, at the local level, art. 113-bis of

Such a fragmented scenario, along with an increase in business activities of Italian foundations that challenge European competition law,[20] diverges dramatically from the report on the preliminary project of Book I of the Civil Code, according to which most foundations in existence at that time were created by a person's will (Commissione Reale per la Riforma dei Codici, 1931). Thus, throughout recent decades many proposals have been put forward to reform the outdated provisions contained in Book I, Title II of the Civil Code (Nuzzo, 2006).

Eventually, in 2001, legislative developments ended in the introduction of the so-called principle of horizontal subsidiarity in article 118, paragraph 4 of the Italian constitution, which establishes, "The State, Regions, metropolitan Cities, Provinces and Municipalities shall promote the autonomous initiatives of citizens, both as individuals and as members of associations, in carrying out activities of general interest, on the basis of the principle of subsidiarity".[21] As stated by the Italian Council of State, the new relationship between private and public actors that is shaped by constitutional principle, invests primarily civil society organizations, rather than the state, with the promotion of general welfare.[22]

Legislative Decree of Aug. 18, 2000, No. 267. E.g., the Fondazione Museo delle Antichita' Egizie of Torino, the Fondazione Torino Musei.

[20] Case C-222/04, Ministero dell'Economia e delle Finanze v. Cassa di Risparmio di Firenze SpA, Fondazione Cassa di Risparmio di San Miniato and Cassa di Risparmio di San Miniato SpA, 2006 E.C.R. I-00289.

[21] Article amended by the Constitutional Law of Oct. 18, 2001, No. 3.

[22] Cons. stato, Sez. norm., Parere 1 Luglio 2002, No. 1354, para. II, 3.1.

Basing on this fundamental premise, following a government attempt to draw the foundations of banking origin into the public sector, the Italian Constitutional Court has asserted the private and autonomous identity of these foundations (as "*being among members of the organization of a free society*"), and consequently declared unconstitutional certain Treasury regulations intended to reduce the autonomy of foundations by changing the sectors where they can pursue their socially oriented goals.[23]

Beyond the universe of foundations of banking origin, the amended article 118 Const. came to affect the entire nonprofit sector, which led urging Italian lawmakers to adopt a legal and fiscal regime that supports the role of private philanthropy in the development of a new welfare society (Agenzia per le ONLUS, 2010; ACRI, 2011).

Most crucially, by enhancing foundations' freedom of action, the principle of horizontal subsidiarity propels a radical shift in the regulatory approach taken by the 1942 Civil Code: from state *control* over foundations' policy and program matters toward foundations' *accountability* to the public. To date, however, aside from specific laws and regulations—regarding foundations of banking origin, nonprofit organizations of social utility, and social enterprises in particular—the Italian legal pattern may be deemed to be right at its beginning as far as the implementation of accountability measures is concerned (Givone et al., 2007). Thus, strengthening the link between

[23] Corte cost., 29 Sett. 2003, No. 300; Corte cost., 29 Sett. 2003, No. 301.

the autonomy and accountability of foundations in accordance with the constitutional principle of horizontal subsidiarity could be singled out as one of the most challenging issues to be addressed within the next expected reform of Italian law for nonprofit organizations.

2. U.S. pattern in a comparative perspective

According to leading studies, "[t]he foundation as an American institution is largely a development of the twentieth century. Charitable trusts, usually small and for fixed and often narrow purposes, are nearly as old as history, but they lacked the special ingredient which makes the modern foundation dynamic—wide freedom of action" (Andrews, 1954).

In contrast to such a special ingredient featuring the venture-capital function of modern philanthropy (Select Comm. to Investigate Foundations, 1953) the state scrutiny over foundations is identified as the key reason why "[n]owhere among the countries of western Europe, where a secularization took place in the eighteenth and nineteenth centuries, can we find a group of organizations similar in number and size to the great foundations in the United States" (Kiger, 1954).

Indeed, the latest available data of the Statistics of Income Division of the Internal Revenue Service (hereinafter IRS) indicate that the number of returns filed by U.S. private foundations with the IRS increased from 31,171 in 1985 (encompassing 28,599 *non-operating* foundations and 2,571 *operating* foundations), to 90,850 in 2008

(encompassing 83,024 *non-operating* foundations and 7,826 *operating* foundations).[24] Over the same period, the fair-market value of total assets and total revenue reported by U.S. private foundations increased from $94.9 billion and $16.1 billion in 1985 to $526.5 billion and $49.6 billion in 2008, respectively. Total expenses rose from $7.1 billion in 1985 to $60.3 billion in 2008. Of these expenses, contributions, gifts, and grants paid for by foundations for charitable purposes were the major component, rising from $5.1 billion in 1985 to $42.8 billion in 2008, with a cumulative real growth of 166% (SOI, 1985-2008).[25]

As the number of foundations and their contributions to economic and social life increasingly grow, a wide freedom of action is still perceived as a distinguishing feature of the sector (Fremont-Smith, 2004). Yet, federal and state lawmakers have been striving for a balance between accountability and autonomy for nonprofits since major stories of self-dealing and mismanagement of charitable funds came to challenge the classic *board governs, attorney general en-*

---

[24] Overall, the number of information returns filed by nonprofit charitable organizations—including the organizations described in the IRC §501(c)(3) other than private foundations, religious organizations, and organizations with receipts under $25,000—increased from 106,449 in 1985, to 315,184 in 2008 (SOI, 1985-2008).

[25] As noted in the text, *non-operating* foundations account for over 90% of annual returns filed by private foundations with the IRS. They hold a similar proportion of the aggregate fair-market value of total assets. Furthermore, *non-operating* foundations earn the majority of total revenue and, because of their legal requirement to make charitable distributions, account for nearly all of the contributions, gifts, and grants reported by the private foundation sector (SOI, 1985-2008).

forces structure and raised the question: "How private is private philanthropy?" (Brody, 2006).

In fact, the assumption that a *nonprofit* organization is less likely to abuse the trust placed in it (Hansmann, 1980) is confronted with numerous charitable accountability issues that have led to congressional action and proposals for reform in particular: excessive executive compensation, lack of board oversight and accountability, the growing commerciality of the nonprofit sector, loss of mission, little charity service, misleading and/or excessive fundraising practices, incomplete and inaccurate reporting, self-dealing, and inadequate oversight of charities and enforcement of the laws that govern them (Covington, 1994; Hopkins, 2009).

Consequently, although Anglo-American philanthropy marked the 400th anniversary of the 1601 Statute of Charitable Uses, which began the modern legal system for overseeing charity,[26] American scholars themselves point out that "[t]o this day and in the United States, the law provides at best an incomplete solution to problems of nonprofit governance and the protection of the public interest" (Brody, 2006).

Foundations in particular, within the universe of charitable organizations described under §501(c)(3) of the Internal Revenue Code (hereinafter IRC), have been generating political debate at both the federal and state levels, with questions raised and positions taken. While

---

[26] 43 Eliz., ch. 4 (1601), titled An Act to Redress the Misemployment of Lands, Goods, and Stocks of Money heretofore Given to Charitable Uses.

almost all those involved condemn the abuses, not all agree on how widespread the problem is or what reforms are appropriate (Fremont-Smith, 2007; Fishman, 2003; Frumkin, 2001).

In essence, from the realm of congressional reports and proposals for change and further enhanced in the wake of the 2002 Sarbanes-Oxley Act,[27] a crucial question arises: “Is more regulation needed? If so, how much and by whom?” (Covington, 1994). After all, scholars have argued, “to seek a legal remedy is to raise yet another question: who decides? On the private side, candidates include the board, donors, beneficiaries, the community, and the public at large; on the public side, we have the attorney general (and other administrators), the legislature, and the courts. Each of these possible loci of authority has advantages and disadvantages, depending on our view of the appropriate control over the assets, structure, and activities of nonprofit organizations” (Brody, 2006).

Advocates for government regulation, arguing that foundations should not be left to regulate themselves as philanthropic giving cannot be private giving, contrast with the advocates for foundations’ responsibility without regulation, stressing, rather, that “acceptance of government’s right to lay down programmatic requirements opens the doors for government to determine almost any aspect of nonprofit behavior” (Covington, 1994).

[27] Sarbanes-Oxley Act of 2022, Pub. L. No. 107–204, 116 Stat. 745 (codified as amended in scattered sections of 11, 15, 18, 28, 29 U.S.C.).

Eventually, charity watchdogs, while affirming the importance of ethical conduct by the sector, are disinclined to press for accountability through legislative or regulatory reform. Rather, they focus, almost exclusively, on mechanisms of self-regulation and donor education to address charitable misconduct. Nevertheless, the effectiveness of self-regulation by the U.S. nonprofit sector is also challenged by critical issues because, so far, it has not had the incentives or enforcement mechanisms available to deal with significant problems and violations (Sidel, 2005). Ultimately, as the latest studies note, should any organization fail to voluntarily adhere to rules, "a self-regulator can do nothing greater than terminate an organization's membership or otherwise withdraw its seal of approval" (Garton, 2009).

3. This article's aims

At present, the Italian legal pattern for foundations is in a state of flux. Along with the very recent growth of the sector, major reforms of the constitution have formalized the passage from the welfare state to the horizontal subsidiarity model (Antonini and Pin, 2011; Felice, 2007). Consequently, several voices urge that the substantive and tax regime for foundations be consistent with the new role that private philanthropy is assigned under the amended Article 118 (ACRI, 2001; Agenzia per le ONLUS, 2010).

The U.S. legal pattern for foundations, instead, stems from a partnership between private philanthropy and the state, which was established by the 1601 Statute of Charitable Uses, in which "the state filled in gaps left by charity rather than charity filling in gaps left by the state" (Charitable Trust Comm., 1952). Accordingly, while no issues are more critical than nonprofit autonomy and public accountability, efforts to devise an appropriate means of regulation hold on to the tradition of noninterference with private philanthropy.

Thus, with the aim of providing helpful guidance for the next reform of Italian foundation law, a comparative investigation of the U.S. pattern is critically valuable. In essence, this essay will take the following approach:

- *First*, it will investigate the impact of federal and state laws on various stages of the life of foundations, with a special focus on the rationales behind the evolution of the pattern from the earliest developments up to the most recent proposals for change.
- *Second*, it will explore the role of self-regulation in strengthening accountability by the U.S. foundation sector as well as enforceability issues that still challenge the effectiveness of voluntary action of foundations.
- *Finally*, it will outline key empirical and theoretical factors influencing the latest trends in the U.S. pattern for foundations as they may provide enlightenment in addressing crucial issues that have just emerged from the recent renaissance of Italian foundation sector.

4. U.S. foundations and law

Several sources of law at both the state and the federal levels, with differences occurring across the individual states, define the U.S. legal framework for foundations. These include trust law, corporation law, and tax law among others. Moreover, various regulations on contracting, labor and employment, torts and insurance, employee benefits, antitrust, and bankruptcy, as well as laws governing specific industries such as hospitals and healthcare, address issues that affect charitable organizations (Hopkins, 2011). Yet, no laws within this complex structure grant attorneys general, courts, or tax authorities controlling powers over foundation creation, governance, and operation.

1) The creation stage

Under state law, foundations are allowed wide latitude in the manner and means by which they are created. Founders can generally choose between two organizational forms—the corporate[28] or trust[29] form—with different legal regimes governing the liability, governance, and fiduciary standards (in practice, as described below, uniform fiduciary standards and reporting requirements apply to *all* exempt foundations, regardless of the organizational structure).

Donors are also allowed a broad freedom in selecting *their* philanthropy (Hansmann, 1981). In fact, state nonprofit corporation statutes, although differing from each other, generally permit *any lawful* pur-

---

[28] Usually, *operating* foundations are incorporated.

[29] Usually, *grant-making* foundations are in the form of trusts.

pose that aims to benefit a broad class of society or society in general.[30] Furthermore, the law of charitable trusts imported from the preamble to the Elizabethan Statute of Charitable Uses the principle that charitable purposes "are designed to accomplish objects that are beneficial to the community—i.e., to the public or indefinite members thereof"[31] and that "there is no fixed standard to determine what purposes are of such interest to the community, for the interests of the community vary with time and place."[32] In turn, the common law concept of charity permeates the list of exempt purposes set forth in §501(c)(3) of the IRC,[33] which may qualify a foundation as a *charitable* organization exempt from federal income tax and eligible to receive charitable deductions.[34] Indeed, under Treasury regulations, the term *charitable* is construed broadly to include, beyond its ordinary sense of meaning relief for the poor and distressed or the underprivileged, the "advancement of religion," "advancement of education or science," "erection or maintenance of public buildings, monuments, or work," "lessening of the burdens of Government," and "promotion of social welfare."[35]

Finally, aiming at charging a fee for its services and products or for the use of its facilities does not prevent a U.S. foundation, whether

---

[30] *E.g.,* Cal. Corp. Code § 5111 (2012); N.Y. Not-For-Profit Corp. Law § 201 (2012). *See also* Model Nonprofit Corp. Act § 3.01 (2008).
[31] Restatement (Third) of Trusts § 28 cmt. a (2003).
[32] Restatement (Third) of Trusts § 28 cmt. a (2003).
[33] Bob Jones Univ. v. United States, 461 U.S. 574, 588 (1983).
[34] I.R.C. §170, §§2055, 2522.
[35] Treas. Reg. § 1.501(c)(3)-1(d)(2).

incorporated or formed as a charitable trust, from being entitled to nonprofit status and enjoying tax exemption, subject to the non-distribution constraint imposed by state nonprofit corporation statutes and trust law[36] (Hansmann, 1980) as well as to the IRC's prohibitions against any direct or indirect inurement to insiders[37] and any more-than-incidental private benefit.[38]

2) Foundations' governance and operation

Generally, state corporate statutes provide only for the barest of structures for governance and operation, leaving, instead, the bylaws to work out and provide for any additional, desired restrictions on governance and the management of affairs.[39]

In essence, once a foundation has been established, the board is endowed with full governance authority:[40] as a general rule, in fact, courts will not interfere with the management of charitable organizations, unless there is a willful abuse of the discretionary powers of fiduciaries, neglect of duty, or bad faith.[41] In this respect, in determining the liability for a breach of fiduciary duties, recent trends that have developed in state nonprofit corporation statutes are to adopt

---

[36] *E.g.,* Cal. Corp. Code § 5410 (2012); N.Y. Not-For-Profit Corp. Law § 508 (2012). *See also* Model Nonprofit Corp. Act § 26 (1964), *and* Restatement (First) of Trusts § 376 (1935).

[37] I.R.C. §501(c)(3).

[38] I.R.C. §501(c)(3).

[39] *E.g.,* Cal. Corp. Code § 5151 (2012). *See also* Model Nonprofit Corp. Act § 12 (1964).

[40] *E.g.,* Cal. Corp. Code § 5210 (2012); N.Y. Not-For-Profit Corp. Law § 701 (2012). *See also* Model Nonprofit Corp. Act § 17 (1964).

[41] *E.g.,* Cal. Corp. Code § 5223 (2012).

corporate standards (J. Legis. Comm. To Study Revision of Corporation Laws, 1969). Indeed, under the Model Nonprofit Corporation Act of 2008 (patterned after the Business Act of 2002), the standards of conduct and liabilities for directors and officers follow closely the language of business corporation law,[42] as do the provisions on the business judgment shield.[43] Eventually, over the past decades the trust-investment law brought a liberalization of the stricter trust rules (Langbein & Posner, 1976)—e.g., allowing standards of business care and prudence, delegation of investment authority, and expenditure of appreciation—with the aim of meeting demands by trustees or governing boards that sought "to make more effective use of endowment and other investment funds."[44]

Under the federal tax law, the operation of U.S. foundations is subject, above all, to a general rule requiring *any* exempt charitable organization to be organized and operated exclusively to further exempt purposes (except to an insubstantial extent)[45], including that the organization's assets be dedicated to an exempt purpose upon dissolution.

[42] Model Nonprofit Corp. Act, § 8.30 Intro. cmt. (2008) (stating that "the relationship of directors to a nonprofit corporation is more akin to that of directors of business corporations than to that of trustees of their beneficiaries").
[43] Model Nonprofit Corp. Act, § 8.31 (2008).
[44] Unif. Mgmt. of Inst. Funds Act, Prefatory Note (1972).
[45] Better Bus. Bureau of Washington, DC v. United States, 326 U.S. 279, 283 (1945) ("the presence of a single [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly [exempt] purposes").

Accordingly, a U.S. foundation may operate a business as its primary activity and be a *charitable* organization, as long as the business accomplishes exempt purposes. Under the commerciality doctrine, tax exemption may be revoked only if a foundation operates *substantial unrelated* business activities,[46] although it may direct its net income to one or more exempt organizations, the so-called "feeder organizations."[47] In practice, however, the commerciality doctrine is generally invoked in cases in which the organization pays *no* unrelated business income tax (UBIT)[48] on clearly substantial commercial activity and, therefore, appears to be more of a for-profit enterprise than a charitable one.

In addition to these general principles, the IRC's framework provides for a detailed set of substantive rules on foundations, requiring annual distributions equaling 5% of investment assets (i.e., pay-out requirement).[49] They also prohibit foundations from engaging in any act of self-dealing,[50] retaining any excess business holdings,[51] making any jeopardizing investments,[52] and making any taxable expendi-

---

[46] B.S.W. Group, Inc. v. Comm'r, 70 T.C. 352, 358 (1978) ("factors such as the particular manner in which an organization's activities are conducted, the commercial hue of those activities, and the existence and amount of annual or accumulated profits are relevant evidence of a forbidden predominant purpose").
[47] I.R.C. § 502.
[48] I.R.C. §§ 511-514.
[49] I.R.C. § 4942.
[50] I.R.C. § 4941.
[51] I.R.C. §4943. *Cf.* Philanthropic Enterprise Act of 2012, H.R. 4035, 112th Cong. (referred to H. Comm. on Ways and Means, Feb. 15, 2012).
[52] I.R.C. § 4944.

tures,[53] with a two-tier system of excise taxes on foundations and the management of foundations intended to ensure compliance with the law. Either willful repeated acts (or failures to act) or a willful and flagrant act (or failure to act), giving rise to liability for tax under any of these rules, may result in termination of the private foundation status and the imposition of termination taxes.[54]

5. Accountability vs. control

Highlights from the U.S. legal structure suggest that as a basic premise, Americans do not want the state to run charitable organizations. In fact, the law retains jurisdiction in cases of misfeasance and malfeasance by nonprofit fiduciaries.

Traditionally, overseeing charities and enforcing fiduciary duties have been the concerns of state attorneys general and state courts as successors to the English chancellors in equity who regulated the fiduciary conduct of private trustees (Fisch, 1974). Yet, although courts could refuse validation of a charitable trust in the same way as public authorities could deny or revoke a corporate charter, the exercise of these powers carried none of the direct *control* over policy and program matters. Still more significantly, historical developments indicate that only a practical challenge—i.e., “the perpetual duration allowed charitable trusts and the resulting risk that designated charitable purposes may become obsolete as the needs and cir-

[53] I.R.C. § 4945.
[54] I.R.C. § 507.

cumstances of society evolve over time"[55]—forced the U.S. courts to adopt the view that controlling powers as potentially arbitrary as those associated with the application of *cy pres* should be upheld (Fish, 1950).

In recent times, federal law has assumed a significant role in the regulation of the charitable sector (Simon, Dale & Chisolm, 2006) as confirmed by the prevalence of tax code-based provisions governing the behavior of foundations' fiduciaries. Nevertheless, such trends have not affected the core features of the U.S. legal pattern, namely, reliance on periodic reporting and disclosure from the sector in exchange for tax exemption and advantages that charities receive from society and the enforcement of fiduciaries' behavior.

As in the case with the states, in fact, federal oversight through tax exemption chiefly depends on reports. Nonprofit corporations and charitable trusts that qualify as private foundations for federal income tax purposes must file copies of their annual returns, which contain a statement of activity and financial position (Form 990-PF).[56] Moreover, foundations that have unrelated business taxable income must file additional reports (Form 990-T, or Form 1041 for charitable trusts). The reports must meet uniform accounting and reporting measures for nonprofit organizations, which were developed by the Accounting Standards Division of the American Institute of Certified Public Accountants and the Financial Accounting Stan-

[55] Restatement (Third) of Trusts § 67 cmt. a (2003).
[56] I.R.C. § 6012.

dards Board (FASB) as early as the 1970s. Eventually, the failure to file the required returns or the failure to file on or before the due date may result in the loss of exempt status and the imposition of substantial penalties,[57] up to criminal penalties for the willful failure to file returns and for filing fraudulent returns.[58]

Foundations, like all tax-exempt charitable organizations, are also subject to public disclosure requirements: information on the annual return, as well as the application form, must be made available to the public for a period of three years after the date when such returns are filed with the IRS.[59] Failure to comply with a public inspection will subject the organization to IRC penalty provisions.[60]

On the side of fiduciary behavior, the IRC's framework for foundations came to subject *all* tax-exempt foundations (either incorporated or operated as charitable trusts) to uniform, rigorous standards of conduct, as scholars have long recommended (Karst, 1960; Fremont-Smith, 1965; Hansmann, 1981). In particular, the self-dealing rule effectively mandates a federal duty of loyalty on foundation fiduciaries, which, outside the foundation sector, has influenced the format of the intermediate sanctions regime that has applied to public charities since 1996 although with more lenient restrictions and sanctions.[61] Likewise, the payout rule affects fiduciary behavior, by in-

[57] I.R.C. § 6652(c)(1).
[58] I.R.C. §§ 6651, 7203, 7206, 7207.
[59] I.R.C. § 6104(d).
[60] I.R.C. § 6652 (c)(1)(C)(D).
[61] I.R.C. § 4958, codified by Taxpayer Bill of Rights Act 2 (1996).

ducing foundations' managers to make investment assets more productive of current income in order to reach the required distribution level. The jeopardizing investment rule, as well as the excess business holding rule mirror the duty of care and prudent investor rule that are imposed under the state charity law. Finally, the taxable expenditures rule impacts the grant-making process, requiring, above all, the foundations' fiduciaries to exercise expenditure responsibility over grants to non-public charities and imposing an absolute prohibition on legislative lobbying.

6. Search for a rationale

Above all, the U.S. government's enduring recognition of the present and future need for foundations (Select Comm. To Investigate Foundations, 1953) enlightens the political background against the legal framework outlined above and its inherent distinction between *accountability* and *control* (Taylor, 1953).

From a legal perspective, indeed, the mechanism through which the government supports private philanthropy and its contributions to society comprises exemption from tax on an organization's income, deductibility of contributions from the donor's income tax, and deductibility of contributions for estate and gift tax purposes (Simon, Dale & Chisolm, 2006).

Tax exemptions for certain institutions are deeply rooted in the Anglo-American tradition, on the grounds that "the exempt entity con-

fers a *public benefit*, a benefit which the society or the community may not itself choose or be able to provide, or which supplements and advances the work of public institutions already supported by tax revenues."[62] In particular, while the origins of tax exemptions lie in the special privileges that have long been extended to charitable trusts (Keeton, 1962), Congress has exempted the income of charitable organizations from federal taxation since the first federal income tax law was enacted in 1913[63] (and even in a precursor statute, the Tariff Act of 1894[64]), and has allowed charitable contribution deductions since 1917.[65] Since then, provisions for tax exemption and tax deductions have been in every federal income tax law down to §501(c)(3) of the IRC, which lists the charitable organizations that are exempt from federal income tax and eligible to receive tax deductible contributions.[66]

However, while they encourage charitable giving, the tax benefits may become an invitation to abuse. This is particularly true with regard to charitable trusts and foundations established by individual donors or family groups, either recognized as "an essential factor in our progress" or charged of being "charitable masqueraders" when they result in being created by *inter vivos* transfer calculated to re-

[62] *Bob Jones*, 461 U.S. at 587 (emphasis added).
[63] Revenue Act of 1913, Pub. L. No. 63-16, 38 Stat. 114 (1913).
[64] 28 Stat. 509, later held unconstitutional by the U.S. Supreme Court in *Pollock v. Farmers' Loan & Trust Co.*, 158 U.S. 601 (1895).
[65] War Revenue Act, Ch. 63, § 1201(2), 40 Stat. 300, 330 (1917).
[66] I.R.C. §170.

duce income and estate taxes and report no contributions to the general welfare (Select Comm. To Investigate Foundations, 1953).

Giant endowments such as the Rockefeller and Carnegie foundations in the earlier decades of the twentieth century and later the Cullen, Mellon, Duke, and Ford foundations, came under congressional scrutiny, which questioned possible gains to the donor, investment practices, and "sleeping" charitable trusts. Leading universities such as Washington University, Yale University, Columbia University, and New York University have also been under attack because of the apparent trading on their tax-exempt status. Company foundations that serve as special channels for corporate philanthropy have raised further concerns about evasion and fraud (Taylor, 1953).

Tax exemption is thus the key issue driving the major congressional investigations of foundations, such as the 1915 Commission on Industrial Relations (*Walsh* Commission), the 1952 Select Committee to Investigate Tax-Exempt Foundations and Comparable Organizations (*Cox* Committee), the 1953 Special Committee to Investigate Tax-Exempt Foundations and Comparable Organizations (*Reece* Committee), the 1960 Select Committee on Small Business (*Wright Patman* Committee), and the 1965 Treasury Department Report on private foundations, which resulted in the Tax Reform Act of 1969.

Accordingly, the foundation rules currently codified under §§4941-4945 of the IRC were originally intended to address major concerns related to the foundations' tax-exempt status, namely, self-dealing,

delay in benefit to charity, foundations' involvement in business, family use of foundations to control corporate and other property, financial transactions unrelated to charitable functions, and donor involvement in foundation management (Treas. Dep't Report on Private Foundations, 1965).

Under the Tax Reform Act of 1969, instead, *public charities* were excepted from the *private foundations* status and stricter regulations "on the theory that their exposure to public scrutiny and their dependence on public support would keep them from the abuses to which private foundations were subject."[67]

Thus, the tax concern about foundations also justified a higher level of reporting than for public charities[68] as well as a less favorable tax treatment for contributions[69] because Congress determined that foundations "frequently do not make contributions to the operating philanthropic organizations for extended periods of time and in the meanwhile use the funds for investments."[70]

Nevertheless, overall, congressional reports, proposals for reforms, and the IRC's current framework share an essential link between tax-exemption and public accountability. That is, "[f]oundations and charitable trusts receive from society certain privileges, of which tax exemption is the most tangible. . . . In return for such solid advantages,

---

[67] William F. Quarrie, Mable E. Quarrie, and Margaret K. Quarrie v. Comm'r of Internal Revenue, 603 F.2d 1274 (7th Cir. 1979).
[68] I.R.C. § 6033.
[69] I.R.C. § 170.
[70] H.R. Rep. No. 88-749, at 53 (1964).

and also in view of the fact that the ultimate beneficiary is society itself, however particularly the gift may be directed, it seems wholly proper that the foundation or trust should be held accountable for its stewardship" (Andrews, 1956).

In the United States, the relationship between regulation and the autonomy of foundations rests upon this basic premise. On the one hand, the tax-exemption accorded to foundations on the basis of their very necessary role in social and economic life defines the foundations' responsibility to the public to operate wisely and efficiently. In this respect, periodic reporting and board representativeness are viewed as crucial channels for community participation (Taylor, 1953), to the degree that information usually given to the board is extended to outside the governing group (i.e., directors, and trustees) making it possible for others to evaluate policy and programs and thus providing an indirect check on the performance of fiduciaries' duties. Recent efforts aimed at improving accountability through the disclosure of performance goals and measurements, as well as website disclosure of information returns, financial statements, and audit results (Staff of S. Comm. on Finance, 2004), fit in with such an essential principle of public trust that the largest U.S. foundations embraced by the mid-twentieth century (Kiger, 1954). On the other hand, the accomplishment of the "trusteeship" assumed by foundations makes the government, in turn, responsible for protecting the freedom that foundations need in order to achieve their mission.

Throughout the legislative history of U.S. foundations, therefore, debates converge about devising the means to assure public accountability of foundations without sacrificing the basic freedom of action (Fremont-Smith, 1965).

7. U.S. foundations and self-regulation

According to the Principles for Good Governance and Ethical Practice issued by the Panel on the Nonprofit Sector in 2007, "[a]ny approach to preserving the soundness and integrity of the nonprofit community must strike a careful balance between the two essential forms of regulation—that is, between prudent legal mandates to ensure that organizations do not abuse the privilege of their exempt status, and, for all other aspects of sound operations, well informed self-governance and mutual awareness among nonprofit organizations" (Panel on the Nonprofit Sector, 2007).

Improving self-regulation is far from being a recent goal for U.S. charitable organizations. Starting from the earliest development of foundations, foundation representatives have long conceded that private philanthropic organizations, which were presumed to serve the public interest, have a "moral if not legal" responsibility for reporting their activities and warned that failure to report "involves the whole idea of charitable trusts in a suspicion that could be exceedingly dangerous to them all" (Fosdick, 1952).

In fact, commenting on the attitude of foundations toward the principles of public reporting, the 1952 House Select Committee stated, "[t]he larger foundations take the position that as public trusts they are accountable to the public and that the public is entitled to know in detail about their resources, income, expenditures, personnel and programs. Stated in the words of one of their trustees "foundations should not only operate in a goldfish bowl—they should operate with glass pockets" (Select Comm. to Investigate Foundations, 1953).
Detailed annual reports published by most of the larger foundations such as the Carnegie and Rockefeller groups are evidence of their belief that foundations are defined by a public interest because public confidence in foundations rests on knowledge of their activities.[71] Furthermore, in addition to voluntary reporting by individual organizations, national clearinghouses were created by the end of the 1940s "for the purpose of revealing and collecting data of value to philanthropists, administrators of charitable trusts, and the public in general" (Chambers, 1948). The National Committee on Foundations and Trusts for Community Welfare (i.e., today's Council on Foundations) established in 1949, Foundation Library Center established in 1956 (i.e., today's Foundation Center), American Foundations for Social Welfare, and American Foundations Information Service represent the earliest forms of national directories of foundations aimed at creating—in the wake of the congressional investigations of

[71] See, e.g., the annual reports of the Carnegie Corporation of New York (1929, 1931, 1934).

the late 1940s and early 1950s—a framework for greater accountability.

Stemming from such a long-established tradition of voluntary action by the sector, over recent decades substantial steps toward improving accountability standards[72] have been propelled by national watchdogs and so-called "infrastructure organizations" (Smith, 2007) while new evaluation, rating, and charity seal programs are aimed at assisting donors in making sound giving decisions and fostering public confidence in charitable organizations.[73]

Increasingly, recent self-regulatory efforts for accountability and transparency have focused on performance outcomes and board effectiveness (Panel on the Nonprofit Sector, 2007) on the premise that any evaluation approach is inadequate that would address only the financial dimensions of accountability, without addressing such crucial questions as whether the organization is adequately contributing to community well-being. Indeed, in the absence of accountability in programmatic terms, donors and the public "are only looking at the skeletal part of the organization."

[72] Standards for charity accountability have been issued, e.g., by the Independent Sector, Council on Foundations, National Council of Nonprofit Associations, BoardSource, Minnesota Council on Foundations, and Council of Michigan Foundations.

[73] See, e.g., the seal programs implemented by the BBB Wise Giving Alliance—developed from the National Charities Information Bureau (NCIB) and the Philanthropic Advisory service (PAS), the two oldest and most well-known national watchdog organizations—the American Institute of Philanthropy, Charity Navigator, Ministry Watch, Philanthropy Group, and Maryland Association of Nonprofit Organizations Standards for Excellence Institute.

Yet, along with advantages of voluntary accounting to donors and the public, as of the earliest developments, representatives of the U.S. nonprofit community have pointed to the limited value of voluntary reporting for reporting's sake and raised the question: how can foundations be persuaded to report? (Chambers, 1948).

A report issued by the National Center on Philanthropy and the Law in 2005 (National Center on Philanthropy and the Law, 2005), identified several factors that may have an impact on the effectiveness of self-regulation:

1. Sanctions (i.e., sanctions with legal enforceability and those that are *not* enforced by law, such as fines, loss of membership, or public censure)
2. Value of accreditation controlled or mandated by the self-regulatory body
3. Specificity of standards
4. Disclosure of standards
5. Other factors (e.g., allocation of sufficient staff and budget to the self-regulatory function, the history of the self-regulatory body with respect to sanctions, and immediacy of the threat of government regulation)

Overall, data from the selected self-regulatory entities showed that the most significant factor is the *legal* enforceability of sanctions. Based on this premise, the Council on Foundations, while a powerful and efficient source of information and guidance for its members,

was deemed *not* to be a particularly effective self-regulatory model, primarily "because its guidelines are not legally enforceable " (National Center on Philanthropy and the Law, 2005).

Following the legal enforceability of sanctions, another factor contributing significantly to the effectiveness of self-regulation is the self-regulatory body's authority to accredit organizations coupled with the authority to withdraw the accreditation, particularly, when this accreditation is required either to enable the organization to engage in the activities for which it is formed or for funding by the government and private grant makers ((National Center on Philanthropy and the Law, 2005).

From this perspective, the Senate Finance Committee's reform proposals of 2004 recommended that Congress adopt two forms of *incentive-based* regulation (Garton, 2009), which are aimed at encouraging compliance with best practices established by accreditation programs. Above all, according to the 2004 Discussion Draft, "in determining the recipients of Federal government grants and contracts to tax exempt organizations, the responsible Federal government agency issuing the grant or contract would be required to give favorable consideration to organizations that are accredited by IRS designated entities that establish best practices for tax exempt organizations." Furthermore, and most critically, to support accreditation of charities, the Senate Finance Committee conceded that "the IRS would have the authority to base charitable status or authority of a

charity to accept charitable donations on whether an organization is accredited" (Staff of S. Comm. on Finance, 2004).

Whether these proposals are implemented or not, they support the view that self-regulation, although offering many potential advantages (e.g., greater expertise, greater efficiency, independence from central government, and cheaper cost), best serves as a *supplement* to state regulation rather than an alternative as it lacks the weight of sanctions available only to the state (Garton, 2009).

8. Conclusions

Traditionally, the monitoring and enforcement of charitable trusts and foundations in the United States is defined as a state responsibility (Zollmann, 1924) while federal jurisdiction is designed primarily to raise revenue (*not* to regulate). The scenario outlined above shows, however, that beyond performing the support function aimed at encouraging the expansion of the nonprofit sector through tax relief, the tax law also came to regulate the fiduciary behavior of the U.S. foundations' managers, so much so that the IRC's prohibitions against self-dealing and jeopardy investments are often referred to as the federal law *counterparts* of state law duties of loyalty and care (Fremont-Smith, 2004).

From time to time, various proposals have recommended that all nonprofit regulation be removed from the IRS or that some of its powers be transferred to an agency more suited to regulate tax-

exempt entities on the grounds that the IRS's principal focus is tax collection (Karst, 1960; Ben-Ner, 1994; Fleishman, 1999). Nevertheless, recent proposals for reforms retain core features of the existing system and further strengthen the regulatory function of the tax law, including recommendations by the staff of the Senate Finance Committee for introducing *federal* fiduciary duties of the board members or trustees and a *federal* liability for breach of these duties, and eventually investing the Tax Court with the same broad equity powers over charitable fiduciaries as the states have traditionally exercised (Staff of S. Comm. on Finance, 2004).

The use of federal tax law as a vehicle for regulating foundations and the charitable organizations as a whole (through the 1996 step of "intermediate sanctions" reform) has raised major policy issues, and over the decades, many theories have been proposed in an effort to address them (Simon, Dale & Chisolm, 2006). However, the key question relevant to the research's purposes is *why* the tax law and IRS have come to play such a role in the U.S. pattern.

According to U.S. scholars, "[p]erhaps one reason that nonprofit corporation law has to date been largely ineffective in controlling the managers of nonprofit organizations is that tax law has long been the principal tool employed for that purpose. Or perhaps causation runs the other way: we have long relied on tax law to police the conduct of nonprofit managers because nonprofit corporation law has defaulted in this role" (Hansmann, 2001).

Undoubtedly, factors causing the failure of state regulation and the parallel expansion of the tax code regulation of charities are closely connected in that they evoke the need for economic incentives to monitor the sector effectively.

In fact, since the earliest development of the charity law, high costs were the major obstacle to an effective public oversight of the charitable sector, when redress of abuses could be secured only through the Court of Chancery (Charitable Trusts Comm., 1952). In modern times, financial issues have faced charity oversight by the attorneys general in all but a few states, whereas financial incentives (i.e., revenue concerns) invested the IRS with the most strategic position to regulate and oversee the sector.

In the Italian pattern, the latest trends converged around three significant points:

1. Tax law is playing a growing role in the regulation of the nonprofit sector. In particular, the substantive rules provided by the tax law on non-commercial bodies and nonprofit organizations of social utility[74] have served as a valuable remedy to the inadequacy of the Civil Code's outdated framework (e.g., by formalizing the non-distribution constraint).

2. An increase is witnessed in Revenue Agency's monitoring of the nonprofit sector (Agenzia per il Terzo Settore, 2012), along with increasing recourse to cooperation agreements between the former

[74] Legislative Decree No. 460 of 1997.

Agency of the Third Sector (which lacked enforcement powers) and the Revenue Agency.[75]

3. *In an attempt to cut costs*, in March 2012, the Italian government shut down the national Agency for the Third Sector[76] (formerly ONLUS Agency), thus ending the long debate on the establishment of an independent authority to be entrusted with the supervision of the nonprofit sector.

Commenting on these developments, U.S. scholars have considered reliance on the tax law improper, arguing that "the interests of the IRS and the interest of the general public do not entirely coincide when it comes to the behavior of nonprofit organizations" (Hansmann, 2001). Italian studies also warn against the potential risks of investing the tax authority with exclusive monitoring and enforcement powers over the charitable sector as—it is argued—revenue concerns might result in a restrictive interpretation of the law (Barbetta, 2011).

Although realistic, these concerns should, however, be mitigated in two respects:

(1) From an empirical perspective, at present, the financial incentives to gain public trust in the integrity of the sector through effective monitoring and enforcement turn out to be unique to tax authorities.

---

[75] *E.g.,* Protocollo di Intesa Relativo ai Rapporti di Collaborazione tra Agenzia delle Entrate e Agenzia per le Onlus" (2006), *and* Protocollo di Intesa con l'Agenzia delle Entrate per la Collaborazione tra gli Enti e l'Istituzione di un Tavolo Tecnico.

[76] Art. 8, para. 23 of the Law Decree of March 2, 2012, No. 16, converted into Law of Apr. 26, 2012, No. 44.

Thus far, in most states, the attorney general's office notoriously lacks the resources, staff, and interest to monitor charities, and the IRC rules on foundations' fiduciary behavior are the only provisions actively enforced (Dale, 1991). In Italy, budget issues have confronted the Agency for the Third Sector throughout the years of its activities (Agenzia per il Terzo Settore, 2012) ultimately leading the government to close it, whereas the Revenue Agency's focus on nonprofit organizations has been increasing along with the growth of the sector.

(2) The legislative history of the U.S. pattern suggests that the whole matter of foundation regulation is incidental to *tax*. As noted above, the legitimacy of tax exemption has been the key issue driving the major congressional investigations on foundations and charitable trusts over the past century. Indeed, legislative reforms have been discussed in light of the sector's contributions to the public benefit and tax revenues foregone by income tax exemptions and tax deductions. As a telling example, in 1969, Congress replaced the prior law's prohibition on "unreasonable" income accumulations with a pay-out requirement based on a specified percentage of a foundation's non-charitable-use assets on the grounds that the prior rule failed to preclude foundations from holding or investing in assets that produced no current income (e.g., undeveloped land). In fact, Congress determined that although a donor to a foundation would receive an immediate charitable deduction on making a gift of non-

productive assets (or of property converted into such assets by the foundation), there could be an indefinite delay between the loss of tax revenues due to the deduction and benefit intended to accrue to the public from the gift.

To this extent, therefore, the reliance on tax law as a vehicle for regulating and monitoring the foundation sector not only benefits from economic advantages that are currently unavailable to the alternative options but also is consistent with the relationship between the tax benefits and the foundations' responsibility to the public, which constitutes the essential rationale for regulating the sector. After all, in the absence of the fiscal advantages linked with the nature of a foundation's activities (i.e., the social-benefit value), the private identity of the foundation form would entail moving the accountability requirement from state regulations toward self-regulation.

In the end, as described above, historical gaps between the U.S. and Italian legal patterns for foundations have begun to narrow, as a result of the radical changes that have affected the latter very recently. For the foreseeable future, however, much more still has to change in the Italian legal framework so as to address the challenge of horizontal subsidiarity.

Historically, on the basis of the fundamental principle that "it is an injustice and at the same time a grave evil and disturbance of right order to assign to a greater and higher association what lesser and

subordinate organizations can do" (Pius XI, 1931) the *subsidiarity* has indeed been given two concrete implications:

- A positive implication, which requires societies of a superior order to adopt attitudes of help (*subsidium*)—i.e., of support, promotion, development—with respect to lower-order societies, so that intermediate social entities can properly perform the functions that fall to them (Pontifical Council for Justice and Peace, 2004).
- A negative implication, which requires that the state refrain from anything that would *de facto* restrict the space of the smaller essential cells of civil society, whose initiative, freedom, and responsibility must not be supplanted (Pontifical Council for Justice and Peace, 2004).

In both respects, the conclusions drawn from this comparative analysis are quite relevant. In particular, with respect to the *positive* sense of subsidiarity, the effectiveness of the constitutional model clearly relies on favorable tax treatment of foundations. More significantly, the U.S. experience indicates that the extent of tax exemption and charitable deductions, by affecting the size of the tax revenue loss, enhances the economic incentives that may keep tax authority scrutiny directed toward tax-exempt organizations. Eventually, a tax regime conducive to private philanthropy, along with the effective enforcement of tax sanctions, encourages integrity by the sector. In fact, the more valuable the tax benefits are to nonprofit organizations, the more appropriately the threat of the loss of tax-exempt sta-

tus and the imposition of excise taxes on foundations and managers is likely to function as a deterrent against fiduciary misconduct.
With respect to the *negative* sense of subsidiarity, the constitutional principle urges Italian lawmakers to embrace that careful distinction between *accountability* and *control*, as the U.S. pattern has done. Ultimately, concerns among leaders of U.S. foundations that attempts to impose controls would both discourage private giving and threaten the very freedom to pioneer that gives private philanthropy a unique value (Andrews, 1956), indeed suggest that such a course of action would be a crucial step toward the rise of an Italian "law market" (O'Hara & Ribstein, 2009) for charitable giving.

9. References

ACRI (2011). Sedicesimo Rapporto sulle Fondazioni di Origine Bancaria: Anno 2010. Roma: ACRI.

Agenzia per il Terzo Settore (2012). Relazione Annuale sull'Attivita' Svolta dall'Agenzia per il Terzo Settore (1Gennaio–31 Dicembre 2011).

Agenzia per le ONLUS (2010). Relazione Annuale Sull'Attivita' svolta dall'Agenzia per le Organizzazioni non Lucrative di Utilita' Sociale (1 Gennaio–31 Dicembre 2009).

Andrews F.E. (1954). Preface to Joseph C. Kiger, *Operating Principles of the Larger Foundations*.

Andrews F.E. (1956). *Philanthropic Foundations*. New York: Russel Sage Foundation.

Anheier H.K. (2001). Foundations in Europe: A Comparative Perspective, in Andreas Schlüter, Volker Then & Peter Walkenhorst (eds.) *Foundations in Europe*. London: Directory of Social Change, p. 35-81.

Antonini L. - Pin A. (2011). Gli aspetti costituzionali, amministrativi e tributari del Terzo settore, in Stefano Zamagni (a cura di) *Libro bianco sul Terzo settore*. Bologna: Il Mulino, p. 141-171.

Barbetta G.P. (2008). Le Fondazioni di Origine Bancaria: dalla Nascita per Caso all'Esercizio dell'Innovazione Sociale, in Gilberto Turati, Massimiliano Piacenza, e Giovanna Segre (a cura di) *Pa-*

trimoni & Scopi: per un'analisi economica delle Fondazioni. Torino: Fondazione Giovanni Agnelli.

Barbetta G.P. (2011). Il Settore Non Profit Italiano: Solidarieta', Democrazia e Crescita Economica negli Ultimi Vent'Anni, in Stefano Zamagni (a cura di) *Libro bianco sul Terzo settore*. Bologna: Il Mulino, p. 209-243.

Barbetta G.P. and Demarie M. (2001). Italy, in Andreas Schlüter, Volker Then & Peter Walkenhorst (eds.) *Foundations in Europe*. London : Directory of Social Change, p. 163-178.

Ben-Ner A. (1994). *Who Benefits from the Nonprofit Sector? Reforming Law and Public Policy towards Nonprofit Organizations*. 104 YALE L.J. 731 (book review).

Brody E. (2006). The Legal Framework for Nonprofit Organizations, in Walter W. Powell & Richard Steinberg (eds.) *The Nonprofit Sector: A Research Handbook*. New Haven: Yale University Press, p. 243-266.

Cafaggi F. (2000). Prefazione. I Controlli sulle Organizzazioni *Nonprofit*, in Gian Paolo Barbetta & Cristiana Schena (a cura di) *Regolazione e controllo sulle organizzazioni nonprofit*. Bologna: Il Mulino, p. 7-49.

Chambers M.M. (1948). *Charters of Philanthropies*. New York : [s.n.].

Charitable Trusts Comm. (1952). *Report of the Committee on the Law and Practice relating to Charitable Trusts.* London: H.M. Stationery Off.

Comm. on Private Philanthropy and Public Needs (1975). *Giving in America: Toward a stronger voluntary sector.* Report of the Commission on Private Philanthropy and Public Needs. Washington: The Commission.

Commissione Reale per la Riforma dei Codici (1931). Codice Civile Primo Libro: Relazione sul Progetto. Roma: Istituto Poligrafico dello Stato.

Covington S. (1994). *Special Report from the National Committee for Responsive Philanthropy: The New Age of Nonprofit Accountability*. Washington D.C.: National Committee for Responsive Philanthropy.

Dale H.P. (1991). *Tax-Exempt Organizations: Winds of Change*, Norman A. Sugarman Memorial Lecture, Mandel Center for Nonprofit Organizations, Case Western Reserve University, *available at http://archive.nyu.edu/handle/2451/23385*.

Felice F. (2007). *Welfare Society: Dal paternalismo di Stato alla sussidiarietà orizzontale*. Soveria Mannelli: Rubbettino.

Fisch E.L. (1950). *The Cy Pres Doctrine in the United States.* Albany, NY: Bender.

Fisch E.L. (1974). *Charities and Charitable Foundations*. Pomona, NY: Lond Publications.

Fishman J.J. (2003). *Improving Charitable Accountability*, 62 Md. L. Rev. 218.

Fleishman J.L. (1999). Public Trust in Not-for-Profit Organizations and the Need for Regulatory Reform, in Charles T. Clotfelter and Thomas Ehrlich (eds.) *Philanthropy and the Nonprofit Sector in a Changing America.* Bloomington: Indiana University Press, p. 172-197.

Fosdick R.B. (1952). *The Story of the Rockefeller Foundation*. New York: Harper & Brothers.

Fremont-Smith M.R. (1965). *Duties and Powers of Charitable Fiduciaries: The Law of Trusts and the Correction of Abuse*s, 13 UCLA L. Rev. 1041.

Fremont-Smith M.R. (1965). *Foundations and Government*. Russell Sage Foundation, New York.

Fremont-Smith M.R. (2004). *Governing Nonprofit Organizations. Federal and State Law and Regulation*. Cambridge, Mass.: Belknap Press of Harvard University Press.

Fremont-Smith M.R. (2007). *The Search for Greater Accountability of Nonprofit Organizations: Recent Legal Developments and Proposals for Change*, 76 Fordham L. Rev. 609.

Frumkin P. (2001). *Balancing Public Accountability and Nonprofit Autonomy: Milestone Contracting in Oklahoma*. The Harvard Hauser Center for Nonprofit Organizations & The Kennedy

School of Government, Harvard University, Working Paper No. 6.

Galgano F. (1969). Delle Persone Giuridiche: Art. 11-35, in A. Scialoja & G. Branca (a cura di), *Commentario del Codice Civile. Libro Primo – Delle persone e della famiglia.* Bologna: N. Zanichelli, Roma: Soc. ed. del Foro Italiano.

Garton J. (2009). *The Regulation of Organized Civil Society*. Oxford; Portland, Or. Hart Pub.

Giorgi G. (1901). *La Dottrina delle Persone Giuridiche o Corpi Morali*, vol. V. Firenze: Casa Editrice Libraria – Fratelli Cammelli.

Givone F. et al. (2007). Italy, in Helmut K. Anheier H. & Siobhan Daly (eds.) *The Politics of Foundations: A Comparative Analysis*. London, New York: Routledge, p. 224.

Hansmann H. (1980). *The Role of Nonprofit Enterprise*, 89 Yale L.J. 835.

Hansmann H. (2001). A Reform Agenda for the Law of Nonprofit Organizations, in Klaus J. Hopt & Dieter Reuter (eds.) *Stiftungsrecht in Europa*. Köln: Heymann, pp. 241-272.

Hopkins B.R. (2011). *The Law of Tax-Exempt Organizations*. Hoboken, NJ: Wiley.

Hopkins B.R. and Gross V.C. (2009). *Nonprofit Governance: Law, Practices and Trends*. Hoboken, N.J. : John Wiley & Sons.

Hopt K.J. et al. (2009). Feasibility Study on a European Foundation Statute: Final Report. Brüssel: European Commission.

ISTAT (2009). Le Fondazioni in Italia: Anno 2005. Roma: Istituto Nazionale di Statistica.

J. Legis. Comm. to Study Revision of Corporation Laws (1969). *Explanatory Memoranda on N.Y. Not-For-Profit Corporation Law*.

Karst K.L. (1964). *The Tax Exemption of Donor-Controlled Foundations*, 25 Ohio St. L.J. 183.

Keeton G.W. (1962). *The Modern Law of Charities*. London: Pitman.

Kiger J.C. (1954). *Operating Principles of the Larger Foundations*. New York: Russel Sage Foundation.

Langbein J.H. and Posner R.A. (1976). *The Revolution in Trust Investment Law*, 62 A.B.A. J. 887.

Ministero di Grazia e Giustizia (1936). *Codice Civile Libro Primo: Progetto Definitivo e Relazione del Guardasigilli On. Solmi*. Roma: Istituto Poligrafico dello Stato.

National Center on Philanthropy and the Law (2005). Study on Models of Self-Regulation in the Nonprofit Sector, *available at http://www1.law.nyu.edu/ncpl/resources/rp_report.html.*

Nuzzo M. (2006). Riflessioni sulla riforma del Titolo II del Libro I del Codice Civile. In *Il Risparmio*, pp. 5-21.

O'Hara E.A. and Ribstein L.E. (2009). *The Law Market*. Oxford, New York: Oxford University Press.

Panel on the Nonprofit Sector (2007). *Principles for Good Governance and Ethical Practice:* A Guide for Charities and Foundations.

Pius XI (1931). *Quadragesimo Anno*, Encyclical.

Pontifical Council for Justice and Peace (2004). *Compendium of the Social Doctrine of the Church*.

Ponzanelli G. (2000). *Gli enti collettivi senza scopo di lucro*. Torino: Giappichelli.

Select Comm. to Investigate Foundations (1953). *Final Report of the Select Committee to Investigate Foundations and other Organizations*, H.R. Rep. No. 82-2514. Washington: US Government Printing Office.

Sidel M. (2005). *The Guardians Guarding Themselves: A Comparative Perspective on Nonprofit Regulation*, 80 Chi.-Kent L. Rev. 803.

Simon J., Dale H., and Chisolm L. (2006). The Federal Tax Treatment of Charitable Organizations, in Walter W. Powell & Richard Steinberg (eds.), *The Nonprofit Sector: A Research Handbook*. New Haven: Yale University Press, pp. 267-306.

Smith J.A. (2007). Introduction: The Foundation Center Fifty Years On, in Mitch Nauffts (ed.) *Philanthropy in the 21st Century*, p. 1.

SOI (1985-2008). Bulletin Historical Table 16. *Nonprofit Charitable Organization and Domestic Private Foundation Information Returns, and Exempt Organization Business Income Tax Returns: Selected Financial Data*.

Staff of S. Comm. on Finance (2004). *Staff Discussion Draft*, 108th Cong.

Taylor E.K. (1953). *Public Accountability of Foundations and Charitable Trusts*. New York: Russell Sage Foundation.

Treas. Dep't (1965). *Report on Private Foundations*, H. Comm. on Ways and Means, 89th Cong.

Zollmann C. (1924). *American Law of Charities*. Milwaukee, Wis., The Bruce publishing company.

CRC - Centro Ricerche sulla Cooperazione e sul Nonprofit

Working Papers

1) Emilio Colombo - Patrizio Tirelli, *Il mercato delle banane e il commercio equo e solidale,* giugno 2006.

2) Emilio Colombo - Patrizio Tirelli, *Il mercato del caffè e il commercio equo e solidale,* giugno 2006.

3) Gian Paolo Barbetta, *Il commercio equo e solidale in Italia,* giugno 2006.

4) Antonella Sciarrone Alibrandi (a cura di), *Quali norme per il commercio equo e solidale?,* giugno 2006.

5) Emilio Colombo - Patrizio Tirelli, *Il valore sociale delle attività del commercio equo e solidale: l'impatto sui produttori,* maggio 2007.

6) Giacomo Boesso - Fabrizio Cerbioni - Andrea Menini - Antonio Parbonetti, *Foundations' governance for strategic philanthropy*, aprile 2012.

7) Stefan Einarsson - Jasmine McGinnis - Hanna Schneider, *Exploring the talk-action gap: a qualitative investigation of foundation practices over three regime types*, aprile 2012.

8) Marco Minciullo - Matteo Pedrini, *Knowledge transfer methods between founder firms and corporate foundations: upshots on orientation to effectiveness*, maggio 2012.

9) Gian Paolo Barbetta - Luca Colombo - Gilberto Turati, *The impact of fiscal rules on the grant-making behavior of American foundations*, luglio 2012.

Printed by
Gi&Gi srl - Triuggio (MB)
April 2013

ISBN 978-88-343-2549-0