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WHAT LEONA HELMSLEY CAN TEACH US ABOUT THE CHARITABLE DEDUCTION

RAY D. MADOFF*

When Leona Helmsley, the New York hotel and real estate heiress, died in August 2007, she left a will naming both human and canine beneficiaries. However, one of the unnamed beneficiaries of this estate plan is surely the body of scholars interested in studying the role of philanthropy in the United States. By directing that an estimated \$8 billion be used for the benefit of dogs, Mrs. Helmsley brought into high relief policy issues regarding the appropriateness of the unlimited charitable deduction, particularly as it applies to perpetual private foundations.

INTRODUCTION

The story of Leona Helmsley is one that seems better suited to the pages of a comic book than to a newspaper. During life Leona Helmsley had a self-styled regal persona. She and her husband, Harry Helmsley, owned a chain of hotels (including the N.Y. Helmsley Palace) and the advertisement campaign for their empire featured the image of an imperious Leona Helmsley overseeing the staff with the tag line: “the only palace where the queen stands guard.” She was known as the “Queen of Mean” for her domineering ways, and when charged with tax evasion, her conviction (at least in the court of public opinion) was assured when testimony was presented that she had said: “only the little people pay taxes.”

Given her reputation during life, no one was too surprised when, at the time of her death, she left a will that disinherited several grandchildren but left \$12 million for the care of her Maltese terrier—appropriately named “Trouble” for his unfortunate propensity to bite people. At the time, disapproval of the dog bequest was offset by reports of her apparent generosity in leaving the bulk of her estate to her private charitable foundation. However, criticism again erupted when it was disclosed that she had left instructions directing that the assets in the private charitable trust be used for the care of dogs. (To make matters worse, her instructions originally provided

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that the money be used “for the care of dogs and of the indigent.” However, she reportedly had a last minute change of heart and removed “the indigent” from her beneficiaries.)¹ The effect of this plan was that Leona Helmsley had directed that as much as eight billion dollars be committed to the care of dogs.

I. THE TROUBLING NATURE OF THE BEQUEST

What makes this bequest so disconcerting? On the one hand, this bequest might be seen as just another example of an exercise of the eccentricities of the super-rich—like Helmsley’s large bequest for the care of her own dog, Trouble, or her arrangement to have her grave steam-cleaned each year,² or other expenditures of the super rich like multi-million dollar watches or 500-foot yachts that are too large to fit into many harbors. Who are we to say how other people should spend their money? However, this view misses an important distinction between the Helmsley charitable dog bequest and the private yacht: that is, while both involve extravagant expenditures by the wealthy, the private yacht is paid for solely by the person buying it, while a significant portion of the Helmsley dog bequest—like other philanthropic bequests—is subsidized by the U.S. taxpayer. The reason I say this is because charitable gifts—both during life and at death—are examples of tax expenditures. They are functionally the same as other expenditures by the government—like payments for Medicare and Medicaid, early childhood education programs or weapons defense programs—however, the difference is that unlike these traditional government expenditures that are subject to the democratic legislative process, the tax expenditures under the charitable deduction are not. The Leona Helmsley bequest affords us the opportunity to consider whether, in these challenging financial times, it is appropriate for the federal government to continue to give wealthy taxpayers a blank check on the federal budget.

II. CHARITABLE GIVING IN HISTORICAL CONTEXT

Today charitable giving is deeply favored in the law. However, the law governing charitable giving has undergone a dramatic transformation over the history of this country. From the early days of the republic through much of the nineteenth century, transfers for charitable purposes were viewed with suspicion and the law was at times actively hostile to these transfers. This aversion was expressed in two forms: (1) state statutes limit-

1. Stephanie Strom, *Helmsley Left Dogs Billions in Her Will*, N.Y. TIMES, July 2, 2008, at A1.

2. *Id.*

ing individuals' ability to make transfers to religious and other charitable organizations; and, (2) court decisions preventing individuals from establishing their own charitable trusts.

A. *Mortmain Statutes*

During the nineteenth century and through much of the twentieth century, it was common for states to have statutes allowing spouses and children to set aside death bed gifts to religious organizations and other charities. These statutes, called mortmain (from the French, meaning "dead hand"), restricted charitable giving by either disallowing charitable bequests in wills made shortly prior to the donor's death or by prohibiting charitable gifts in excess of a designated fraction of the donor's estate.

Mortmain statutes were ostensibly enacted to address the concern that as people get closer to death, they may be inclined to direct their estates to a religious or charitable organization to ensure their eternal salvation. Thus, mortmain statutes were considered to fulfill two purposes: (1) to protect testators (as well as their rightful heirs) against the testator's improvidence; and (2) to deter clergy and representatives of other charitable organizations from exerting undue influence on the frail and elderly.³ In addition, there was undoubtedly some religious bigotry associated with these statutes as well. As historian Lawrence Friedman described it, "a faint odor of anti-Catholicism also hung over these laws—the fantasy of the evil priest, extorting ransom for the Church from the dying man, as the price of absolution."⁴

Beginning in the 1970's some states' mortmain statutes began to be successfully challenged on a variety of constitutional grounds and other states simply repealed their mortmain statutes. As a result, today only Georgia has a mortmain statute still in effect.⁵ The Georgia statute has very narrow applicability. It only applies to wills made within ninety days of the person's death where the person is survived by a spouse or descendants and the gift to charity is in excess of one-third of a decedent's estate.⁶ Moreover the Georgia statute is further limited by not applying to the extent the value of the estate exceeds \$200,000.⁷

3. Kymson F. DesJardins, *Mortmain Statutes: Questions of Constitutionality*, 52 NOTRE DAME L. REV. 638, 639 (1977).

4. LAWRENCE FRIEDMAN, A HISTORY OF AMERICAN LAW 185 (2005).

5. GA. CODE ANN. § 53-2-10 (2007).

6. § 53-2-10 (A).

7. § 53-2-10 (B).

B. The Precarious History of Charitable Trusts

People often seek to leave instructions in their wills, devoting their property to a particular charitable purpose. Beginning in the sixteenth century English law allowed these bequests through the device of the charitable trust—the technical term for the situation where a person gives property to another with instructions to use that property for a particular charitable purpose. Charitable trusts are so ubiquitous and play such a strong role in our society that it is hard to believe that for much of the nineteenth century American law was hostile to their very existence. However, after the Revolutionary War, American states were in an upheaval over whether they should continue to follow the law of England or create a new American law that better reflected the values of the new democracy. Because the charitable trust was associated with privilege, the dead hand, and massive wealth held in perpetuity, people viewed it with particular suspicion.⁸ There was particular concern about problems that could arise from religious establishments controlling large amounts of property in perpetuity. As James Madison wrote:

But besides the danger of a direct mixture of Religion [and] the civil Government, there is an evil which ought to be guarded agst [sic] in the indefinite accumulation of property from the capacity of holding it in perpetuity by ecclesiastical corporations. . . . The growing wealth acquired by them never fails to be a source of abuses. A warning on this subject is emphatically given in the example of the various Charitable establishments in G.B. [Great Britain] the management of which has been lately scrutinized. The excessive wealth of ecclesiastical Corporations and the misuse of it in many Countries of Europe has long been a topic of complaint. In some of them the Church has amassed half perhaps of the property of the nation. . . . In the U.S. there is a double motive for fixing limits in this case, because wealth may increase not only from additional gifts, but from exorbitant advances in the value of the primitive one. In grants of vacant lands, and of lands in the vicinity of growing towns & Cities the increase of value is often such as if foreseen, would essential controul [sic] the liberality confirming them.⁹

These concerns were not without some merit. In addition to the experiences of Great Britain (where prior to the Reformation much of the land was owned by the Church), the history of Mexico also provides an example of difficulties that can arise when organizations with perpetual life are able to acquire large amounts of land in developing countries.

8. "In the early nineteenth century, charity was associated with privilege, with the dead hand . . . with massive wealth held in perpetuity. None of these was particularly popular." FRIEDMAN, *supra* note 4, at 185.

9. Elizabeth Fleet, *Madison's "Detached Memoranda,"* 3 WM. & MARY Q. 534, 556–57 (1946) (estimated to have been written by Madison between 1817 and 1832).

Catholic missionaries came to Mexico with the sixteenth century Spanish conquest. The clergy played a strong role in the communities and it was not uncommon for people at death to give large amounts of their land to their local churches. Over the centuries, the power of the Catholic Church grew along with the Church's land holdings, to the point where, by the mid-nineteenth century, the Church owned half of the land in Mexico.¹⁰ This extensive land ownership by the Church meant that there was less land available for private ownership, which in turn inhibited the development of a strong middle class.¹¹ The extraordinary wealth of the Church also enabled it to play a strong role in the country's political evolution. The Church actively opposed Mexico's independence from Spain.¹² It was only after President Benito Juarez seized the Church's land in the mid-nineteenth century that the political power of the Church began to diminish.

In the United States, concern about excess land holding by religious and other charitable organizations was addressed by mortmain statutes and by judicial resistance to charitable trusts.

The issue of the validity of charitable trusts in American law came about in the wake of the American Revolution when many state legislatures struck all British statutes from their laws. These included the English Statute of Charitable Uses which had explicitly authorized charitable trusts. While some states subsequently enacted their own statutes, others did not, leaving open the question of whether bequests for charitable purposes would be recognized. This issue came before the United States Supreme Court in 1819 in the case of *Philadelphia Baptist Association v. Hart's Executors*.¹³

Silas Hart, a Virginia resident who died in 1795, had made a bequest in his will to the Baptist Association of Philadelphia.¹⁴ Hart's will directed that the bequest was to be used to educate Baptist youth for the ministry. Virginia was one of the states that had struck all British laws, without enacting its own statute authorizing charitable bequests.¹⁵ Thus, the question

10. Evelyn Brody, *Charitable Endowments and the Democratization of Dynasty*, 39 ARIZ. L. REV. 873, 914 (1997).

11. "The greater became the Church holdings, and they were usually of the best land in a given community, the less land was left for the laity to own, and the fewer were the chances that the very small incipient middle class would get a foothold." WILFRED HARDY CALLCOTT, *CHURCH AND STATE IN MEXICO, 1822-1857*, at 14 (Duke U. Press 1926).

12. Brody, *supra* note 10, at 914.

13. See MARION R. FREMONT-SMITH, *GOVERNING NONPROFIT ORGANIZATIONS: FEDERAL AND STATE LAW & REGULATIONS* 44-45 (2004); HOWARD MILLER, *THE LEGAL FOUNDATIONS OF AMERICAN PHILANTHROPY 1776-1844*, 21-23 (1961) (discussing *Phila. Baptist Ass'n v. Hart's Executors*, 17 U.S.1, 2 (1819)).

14. *Phila. Baptist Ass'n*, 17 U.S. at 2.

15. *Id.* at 12-13.

before the Court was whether Hart's wishes would be given effect. While the Court noted that Hart's philanthropic intentions would have been upheld under the English Statute of Charitable Uses as well as under prior Virginia law, the Court ruled that the statute had fallen in December 1792 when the state legislature struck all statutes or Acts of British Parliament from Virginia law and because there was no statute on point authorizing charitable trusts, the bequest was set aside and the property was instead given to Hart's heirs.¹⁶ Chief Justice Marshall wrote the opinion and Justice Story concurred.

Although this decision was rather technical, it was backed by the reputations of Justice Marshall and Justice Story, two of the most influential jurists of the era, and had an enormous impact on lower courts, which for the next 100 years regularly set aside charitable bequests.¹⁷ In this era courts were generally suspicious of allowing "every private citizen the right to create a perpetuity for such purposes as to him may seem good."¹⁸ In one of the most notorious cases, a New York court set aside a four million dollar bequest from Samuel Tilden (former Governor of New York and almost-President of the United States) to establish the Tilden Trust to fund a public library in New York City.¹⁹ The New York courts refused to give effect to the bequest and instead awarded the money to Tilden's heirs.²⁰ However, there was such a public outcry over this decision that the New York legislature responded by enacting the Tilden Act in 1893 validating charitable trusts in New York.²¹

16. *Id.* at 51.

17.

"The Hart case was followed in Virginia, Maryland, the District of Columbia, and West Virginia for nearly one hundred years; and it influenced the development of charitable trusts in New York, Michigan, Wisconsin, and Minnesota. It had this effect despite the fact that twenty-five years later the Supreme Court reversed itself in *Vidal v. Girard's Executors*, holding that charitable trusts should be afforded recognition in the United States regardless of statutes abolishing English law."

FREMONT-SMITH, *supra* note 13, at 45.

18. FREMONT-SMITH, *supra* note 13, at 45 (citing *Bascom v. Albertson*, 34 N.Y. 584, 614–15 (1866)).

19. Samuel Tilden was the Al Gore of his day. He was the democratic candidate of 1876, the most controversial Presidential election of the nineteenth century. In 1876 Tilden won the popular vote by over 250,000 votes, but after months of dispute, the election was ultimately handed over to the republican candidate, Rutherford B. Hayes. Encyclopedia Britannica, Samuel J. Tilden, <http://www.britannica.com/EBchecked/topic/595754/Samuel-J-Tilden> (last visited Mar. 21, 2010).

20. *Tilden v. Green*, 28 N.E. 880, 889 (1891). The case is discussed and criticized in LAWRENCE FRIEDMAN, *A HISTORY OF AMERICAN LAW* 318 (2005), and in a contemporaneous law review article, J. B. Ames, *The Failure of the "Tilden Trust,"* 5 HARV. L. REV. 389 (1891–1892).

21. FREMONT-SMITH, *supra* note 13, at 46–47 n.123 (discussing the Tilden Acts of 1893, ch. 701, codified at N.Y. Real Prop. § 113; N.Y. Pers. Prop., § 12).

The on-going power of the *Hart* decision was particularly surprising in light of the fact that twenty five years later, in 1844, the Supreme Court reversed itself in the case of *Vidal v. Girard's Executors*, and held that a charitable trust could be upheld even in the face of statutes abolishing English law.²² Yet, it was not until the early years of the twentieth century that charitable trusts came to be generally recognized throughout the United States.²³

What explains this shift in legal opinion about the validity of charitable trusts? On a doctrinal level, the shift has been explained as a result of a deepening understanding of English legal history and the technical question of whether charitable trusts were the product of English statutory law (which had been repealed in many states post-Revolution) or principles of equity and common law (which continued to apply). However, this explanation is incomplete because it fails to take into account the larger social context in which this dispute occurred.²⁴

The late nineteenth century was a time when individuals in the United States began amassing wealth at levels that had never before been held in private hands. At the same time, it also marked a period of growing awareness of the larger societal ills, particularly those suffered by immigrants in the growing American cities. In the end, the combination of societal problems in need of resources and the possibility of devoting a portion of this growing private wealth to the problems of the day outweighed the earlier concerns about the unfettered growth of perpetual charitable organizations. This transformation was also eased by the fact that the course of the nineteenth century also witnessed the proliferation of another entity with perpetual existence: the corporation. This growing familiarity with perpetual organizations in the business context also likely served to decrease people's apprehension regarding perpetual charitable trusts.

Today, charitable trusts have received both legal and social acceptance. Few worry about the societal costs of charitable trusts and large dynastic wealth owned by non-profit organizations (although at \$30 billion, the wealth of the Bill and Melinda Gates Foundation is larger than the gross domestic product of many countries²⁵). Charitable trusts are touted as a win-win, serving the dual purposes of providing resources to address social problems as well as giving people a way to "live on" after death. Despite

22. *Vidal v. Girard's Ex'rs*, 43 U.S. 127, 196 (1844).

23. FREMONT-SMITH, *supra* note 13, at 47.

24. MILLER, *supra* note 13, at 40–41.

25. More than seventy as measured by GDP. See CIA—The World Factbook, <https://www.cia.gov/library/publications/the-world-factbook/fields/2195.html> (last visited Jan. 2, 2010).

this appeal, charitable trusts are not without their problems, particularly those raised by the fact that they exist in perpetuity and that they are heavily subsidized through the tax system.

III. THE SUBSIDY FOR CHARITABLE GIVING— AND SOME OF ITS PROBLEMS

For most of history, charitable giving has occurred independent of any government support. However, for the last century the U.S. government has subsidized charitable donations (both while living and at death) through the charitable deduction.

During life, this subsidy is limited as the charitable deduction is only available to offset approximately one-half of a person's taxable income. However, there is no such limitation for charitable transfers at death. Any individual, no matter how wealthy, is able to avoid all estate taxes by taking advantage of the unlimited charitable deduction. Because of this, Leona Helmsley was effectively able to eliminate most of the tax liability on her \$5 billion plus estate by transferring the bulk of her assets to the Harry and Leona Helmsley Charitable Trust.

People often think of government expenditures solely in terms of direct monetary outlays by the government for particular programs, like Medicaid and Medicare and national defense. However, it has long been recognized that another way that the government spends its resources is through the tax system.²⁶ Some tax deductions (as well as exclusions and credits) can be the equivalent of direct expenditures by the government. These are termed "tax expenditures." As explained by the Senate Budget Committee:

Tax expenditures are revenue losses that occur as a result of Federal tax provisions that grant special tax relief to encourage certain kinds of activities by taxpayers or to aid taxpayers in special circumstances. These provisions are the equivalent of a simultaneous collection of revenue and a direct budget outlay of an equal amount²⁷

When the government grants tax benefits for money spent purchasing a fuel efficient car, it is the same as if the government were assisting the purchaser of the car by contributing to the cost of the purchase price. Tax

26. Leonard E. Burman, *Is the Tax Expenditure Concept Still Relevant?*, 56 NATIONAL TAX JOURNAL 613, 613 (2003), available at <http://ntj.tax.org/>.

27. 122 CONG. REC. S10, 617 (1976) (statement of Sen. Muskie). Since 1974, and pursuant to federal law, the Administration has published a list of tax expenditures as part of its annual budget submission. However, beginning in 2003, with the quasi-repeal of the estate and gift tax, the Administration stopped calculating tax expenditures in connection with the estate and gift. Leonard E. Burman, *Is the Tax Expenditure Concept Still Relevant?*, 56 NAT'L TAX J. 613, 614 n.1 (2003).

expenditure analysis enables the home mortgage deduction to be appropriately analyzed for what it is: a federal grant to people who take out loans to purchase a home that is not available to people who rent or to people who own their homes outright.

In the context of charity, tax expenditures operate like matching grants. As one scholar explains:

The charitable deduction makes the government a partner in every gift-giving venture; a taxpayer in the (hypothetical, but arithmetically convenient) [fifty] percent bracket, for instance, can be seen as joining forces with the government to give equal amounts to the cause chosen by the taxpayer (with characteristics or minimum qualifications set by the government).²⁸

When a taxpayer who would otherwise be subject to a forty-five percent tax rate makes a deductible transfer of \$100 to the American Red Cross and gets a reduction in his taxes of forty-five dollars, it is the same as if the taxpayer were contributing fifty-five dollars to the Red Cross and directing the government to make a matching grant of forty-five dollars to the Red Cross.

The charitable deduction is a particularly costly expenditure. The New York Times reported in 2007 that: “[t]he charitable deduction cost the government \$40 billion in lost tax revenue last year, according to the Joint Committee on Taxation, more than the government spends altogether on managing public lands, protecting the environment and developing new energy sources.”²⁹

Saul Levmore supports the charitable deduction as an efficient way for the government to get information from the populace regarding which programs it ought to support. He analogizes the charitable deduction to the taxpayer check off regarding financing elections, but regards the charitable deduction as superior because it is likely to reflect a more thoughtful choice since it requires a cash outlay by the donor.

While the charitable deduction does provide some information to the government about how some taxpayers would like to direct governmental resources, there are nonetheless serious policy concerns with using this as a directive for governmental expenditures, particularly in the estate tax context.

Most significantly, the matching grant program is only available to the charitable donations of the very wealthy. For income tax purposes, it only applies to those who itemize their deductions and for gift and estate tax

28. Saul Levmore, *Taxes as Ballots*, 65 U. CHI. L. REV. 387, 405 (1998) (footnote omitted).

29. Stephanie Strom, *Big Gifts, Tax Breaks and a Debate on Charity*, N.Y. TIMES, Sept. 6, 2007, available at <http://www.nytimes.com/2007/09/06/business/06giving.html>.

purposes, it only applies to individuals with estates that are larger than \$3.5 million (the exemption amount for 2009). Thus, if a person with a multi-million dollar estate, subject to a forty-five percent tax, makes a \$100,000 charitable donation, that donation is functionally equivalent to the donor making a \$55,000 donation and the federal government making a \$45,000 donation to the charity chosen by the wealthy donor. However, if that same \$100,000 donation is made by someone who is not otherwise subject to the estate tax (because her estate is less than \$3.5 million in 2009) then the charitable bequest offers no financial benefit to the donor's estate, and there is no functional federal contribution to the donor's chosen charity. In this way, the matching grant program is highly distorted because it only takes into account the preferences of the wealthiest Americans.

This matching grant for the preferences of the wealthy is particularly troubling due to the fact that wealthy Americans tend to make very different types of bequests than their countrymen. While most Americans direct their charitable dollars to religious organizations, approximately three quarters of all bequests reported on estate tax returns go either to private foundations or educational institutions.³⁰ This type of giving by the wealthy raises the question of whether the charitable deduction is the most efficient use of taxpayer dollars as charitable gifts to private foundations and educational institutions each raise policy concerns.

Private foundations receive almost half of all charitable bequests. They are a form of charitable trusts that do not generally engage in charitable work themselves, but instead dispense a portion of their assets each year to support the work of other charitable organizations. The vast majority of private foundations are designed to exist in perpetuity and therefore only spend a small portion of their asset value each year on charitable endeavors. Thus, although a taxpayer transferring one million to his charitable foundation will get an up front deduction worth \$450,000 (effectively a \$450,000 matching grant from the federal government), the foundation will only be required to spend about \$50,000 each year. Since this \$50,000 is just as likely to be spent on administrative expenses as it is on charitable grants, this further lessens the likelihood of charities ever receiving the full benefit of the one million dollars.

The second largest recipient of beneficence from wealthy individuals is educational institutions. While education plays an important role for all sectors of society, the allocation of resources by the wealthy raises other issues. Rather than distributing this wealth broadly, a disproportionate

30. GIVING USA 74-75 (2007).

share of these bequests goes to a small number of selective, socially prestigious schools. Professor Miranda Perry calculates that

[Twenty-five] elite private colleges and universities (out of almost 1,700 private colleges and universities) and ten socially prestigious private primary or secondary schools (out of over 27,000 such institutions) received approximately [twenty-six percent] of all education bequests reported on 2005 estate tax returns.³¹

It is unlikely that the population as a whole would support federal matching grants for Exeter Academy, while so many public schools are failing to meet the needs of the larger population. Professor Rob Reich has argued that this type of educational philanthropy can actually impose a societal detriment by increasing the gap between the wealthy and the poor, particularly in the context of education.³²

Finally, even when charitable dollars are oriented towards the truly needy it is still questionable whether we really want private individuals effectively directing so much federal resources toward their chosen causes. The Gates Foundation gives a significant amount of its grants to improve the lives of the poor in developing countries. While this is important work, the effect of the charitable deduction is that “the American public effectively underwrote several billion dollars worth of foreign aid by private individuals, even though poll after poll shows Americans are at best ambivalent about using tax dollars in such assistance.”³³

IV. THE PARTICULAR PROBLEM OF PERPETUAL PRIVATE FOUNDATIONS

The subsidy for charitable deduction is particularly troubling as it applies to perpetual private foundations (like the Harry and Leona Helmsley Trust). Private foundations are the most common recipient of charitable bequests. Private charitable foundations have made many important contributions, and my complaint is not with the organizations per se. Rather, my concern is that the law governing these private charitable foundations is more concerned with allowing these organizations to achieve perpetual existence than it has been with ensuring that they serve their charitable goals.

Private charitable foundations are a form of charitable trust that do not engage in charitable activities directly, but merely hold money for disbursal

31. Miranda Perry Fleischer, *Charitable Contributions in an Ideal Estate Tax*, 60 TAX L. REV. 263, 303 (2007) (footnotes omitted).

32. See generally Rob Reich, *A Failure of Philanthropy: American Charity Shortchanges the Poor, and Public Policy is Partly to Blame*, STANFORD SOC. INNOVATION REV. 24 (2005), available at http://www.ssireview.org/images/articles/2005WI_Feature_Reich.pdf.

33. Strom, *supra* note 29.

to other organizations that do. In addition, a private foundation is typically funded by a small number of people. The Bill and Melinda Gates Foundation, the Ford Foundation and the John D. and Catharine T. MacArthur Foundation are examples of some of the largest private charitable foundations, but there are many smaller ones as well. Private charitable foundations, like other charitable trusts, are not subject to any time limitation.

Federal tax law encourages donations to these perpetual entities by granting an up-front deduction for the full amount of money transferred to the foundation, even though there may be a significant lag time before the money is eventually disbursed for charitable purposes. How much lag time is there between the time of the deduction and the time of the distribution for charitable use? A lot. These organizations are only required to spend five percent of their asset value each year. Moreover, in meeting this five percent minimum, foundations are allowed to count trustees' salaries and other administrative expenses as part of their charitable spending. Thus, if the assets of the foundation are valued at one million dollars, the trustees are only obligated to spend \$50,000 each year. Moreover, since administrative expenses, including trustees' salaries, also count towards this minimum, if the trustees are making an annual salary of \$30,000 and the trust has \$10,000 of other annual administrative expenses (such as rent or legal or accounting fees), the trust need only commit \$10,000 of trust assets to charitable purpose each year. Yet the full one million still qualified for the charitable deduction at the time of transfer.

The value of the five percent rule is that provided the charitable foundation can earn a rate of return of at least five percent, the principal can be preserved and the organization can be assured of perpetual life. However, the cost of this perpetual life is that fewer dollars are being currently spent on charitable purposes. In 2003 legislation was proposed that would have required foundations to devote the full five percent of asset value towards true charitable expenditures barring foundations from counting operating expenses (like rent and salaries) towards the five percent minimum. If that law had passed, then a trust with a value of one million dollars would have been required to devote the full \$50,000 to charity in order for transfers to that trust to qualify for the charitable deduction. But private foundations successfully fought this legislation by arguing that its effect would be to destroy perpetual life for charitable trusts. The argument was that if they only earned six percent each year and they had administrative expenses of two percent, then the obligation to spend five percent on charitable giving would reduce their capital and could eventually deplete their resources to nothing. The lobbying was successful and the bill did not pass.

V. PROBLEMS WITH PERPETUAL CHARITABLE TRUSTS

The perpetual charitable trust has such a presence in our society that it is hard to imagine any other type of charitable giving. However, periodically throughout both English and American history, people have questioned the value of establishing charitable trusts in perpetuity. Professor Evelyn Brody has traced some of these critiques.³⁴

The author Anthony Trollope illustrated the corruption and waste that can come from perpetual charitable trusts in his 1855 novel *The Warden* which describes a medieval trust established in 1434 for the support of 12 retired wool-carders (a wool carder was a person who cleaned wool in preparation for spinning). Trollope describes how, while the value of the trust grew enormously over the years, the purposes for which it had been established did not—particularly since wool-carders had been replaced by machines in the prior century. Moreover, Trollope illustrates how through time, the true beneficiaries were the trustees who received management fees far greater than the amount afforded the so-called beneficiaries of the trust.

In the year 1434 there died at Barchester one John Hiram, who had made money in the town as a woolstapler, and in his will he left the house in which he died and certain meadows and closes near the town . . . for the support of twelve superannuated wool-carders . . . From that day to this the charity had gone on and prospered—at least, the charity had gone on, and the estates had prospered. Wool-carding in Barchester there was no longer any; so the bishop, dean, and warden . . . generally appointed some hangers-on of their own; worn-out gardeners, decrepit gravediggers, or octogenarian sextons, who thankfully received a comfortable lodging, and one shilling and fourpence a day, such being the stipend to which, under the will of John Hiram, they were declared to be entitled.³⁵

In 1880 the English reformer Courtney Kenny wrote an essay outlining the fundamental problems with perpetual charitable trusts. Kenny began with his observation that perpetuity creates the paradox “that whilst charity tends to do good, perpetual [c]harities tend to do evil.”³⁶ The main problem with perpetual endowments for charities lies in “the inevitable tendency of endowed charities to be either neglected or perverted as time runs on. Hence it is utterly inexpedient to narrow their resources during their youth, for the purpose of augmenting their superfluities in their decrepitude.”³⁷

34. Brody, *supra* note 10, at 917–19.

35. *Id.* at 898 (citation omitted).

36. *Id.* at 919 (citation omitted).

37. *Id.* (citation omitted).

In the United States, Julius Rosenwald, who has been described as “the greatest twentieth-century donor you’ve never heard of,” has made the most forceful arguments against perpetual charitable endowments.³⁸ Julius Rosenwald made his wealth as one of the early owners and developers of the Sears Roebuck Company. Rosenwald, like many other titans of wealth, in the later part of his life, became a philanthropist. Through his philanthropic work, Rosenwald was responsible for the establishment of 5,357 schools to serve rural Black communities in the South. He also donated large amounts of money to the University of Chicago and was the major contributor to the Chicago’s Museum of Science and Industry (and resisted attempts to have the building named the Rosenwald Museum). However, unlike other philanthropists of his day, Rosenwald was adamantly opposed to making his charitable grants in perpetuity. When he gave \$2 million dollars to the University of Chicago, he did so only on the condition that the money not be added to the University’s endowment (the University instead created a special account for the Rosenwald donations which was exhausted by 1942). When he established his private foundation, he included a provision in the trust that all assets must be spent within 25 years after his death. In the end, the Rosenwald Fund had donated over \$70 million to public schools, colleges and universities, museums, Jewish charities and black institutions before funds were completely depleted in 1948.

In addition to engaging in his own philanthropy, Rosenwald had another personal mission—to discourage other philanthropists from tying up their philanthropic bequests in perpetuity. Rosenwald laid out his arguments in a series of articles beginning with an article published in the *Atlantic Monthly* in 1929 entitled “Principles of Public Giving.” This article has been described as the most important article written by a philanthropist since Andrew Carnegie wrote “The Gospel of Wealth” in 1889.

In urging his fellow philanthropists not to tie up their wealth in perpetuity, Rosenwald directly took on people’s desire to preserve their reputations in perpetuity:

I am certain that those who seek by perpetuities to create for themselves a kind of immortality on earth will fail, if only because no institution and no foundation can live forever. If some men are remembered years and centuries after the death of their last contemporaries, it is not because of endowments they created. The names of Harvard, Yale, Bodley, and Smithson, to be sure, are still on men’s lips, but the names are now not

38. Martin Morse Wooster, *The Greatest 20th-Century Donor You’ve Never Heard of*, *PHILANTHROPY MAGAZINE*, May/June 2006, available at <http://www.philanthropyroundtable.org/article.asp?article=1219>. In writing this document, while Microsoft Word easily recognizes the names of the other well-known philanthropists, it suggests alternate spellings for Rosenwald.

those of men but of institutions. If any of these men strove for everlasting remembrance, they must feel kinship with Nesselrode, who lived a diplomat, but is immortal as a pudding.³⁹

What is wrong with perpetual charitable giving? At first glance, perpetual charitable giving appears to be ideal. After all if charitable giving is good, isn't it even better for there to be more of it? However, the problem with this analysis is that it is based on two false premises: the first is that giving in perpetuity creates more total charitable dollars than giving outright, and the second is that people can address problems in the future as effectively as they can address problems in their own time. Both of these assumptions are questionable.

Many people undoubtedly choose to establish perpetual charitable trusts on the assumption that more philanthropic dollars will ultimately be available by spending only income and preserving the principal in perpetuity. It is not surprising that people would assume that an infinite stream of payments (which is provided by setting aside principal and only spending income) is ultimately going to be greater than immediately spending the underlying income, and anyone familiar with the story of the goose that laid the golden eggs knows the importance of preserving principal. However, fairy tales notwithstanding, this assumption of relative economic values does not necessarily hold true because it fails to take into account the time value of money. The time value of money reflects the fact that because of lost earning capacity, a dollar one year from now is worth less than a dollar today. In many cases, setting principal aside and spending only income (even in perpetuity) produces less overall wealth than spending principal today.

Consider the example of a person with one million dollars to commit to charity. If it is spent immediately then society gets the immediate full value of the one million dollars. What if instead the one million is set aside in a charitable trust earning five percent each year and the trust commits to spend all of its income on charitable endeavors (leaving aside the issue that it would likely need to spend a portion of that income to ongoing administration costs). After how much time will the charities get the one million dollars? Initially one might be inclined to think that it takes twenty years of \$50,000 payments to equal \$1 million. However, this fails to take into account the time value of money and the fact that each \$50,000 payment is worth less in current dollars as each year passes. Thus, if \$50,000 were to be paid one year from now (as opposed to today), and if the rate of inflation

39. Julius Rosenwald, *Principles of Public Giving*, 143 THE ATLANTIC MONTHLY 599, 605 (1929).

was five percent, then that \$50,000 one year from now would only be worth \$47,619 in today's dollars. The \$50,000 distributed two years from now is only worth \$45,351 in today's dollars. How long does it take for the sum of these annual payments to equal one million dollars in today's dollars? Surprisingly, the sum of payments will *never* equal the present value of one million dollars. After 100 years the sum of the present value of the annual payments is about \$940,000 but due to the diminished present value of payouts made way in the future, the next 100 years only adds \$10,000 in value in today's dollars and no matter how far into the future you go, the sum never equals the value of one million dollars today.

In addition to the limited economic value of perpetual charitable giving, there is another more deep-rooted problem. The perpetual charitable trust is founded on an assumption that people can make intelligent decisions about the use of resources in the distant future. It is not surprising that people would have this perception. The psychologist Daniel Gilbert has explained how humans are hard-wired to make decisions on the assumption that the future is going to be essentially the same as the present (or in the words of Dan Quisenberry—the future is the same as the present, only longer). Yet, by looking back in time we can see how flawed this thinking is. Imagine the smartest person living 500 years ago (Leonardo da Vinci perhaps)—is there any question that no matter how extraordinarily smart that person was in their own time, their ability to make an intelligent allocation of resources in the twenty-first century would be extremely limited? Now extend that even further back to 1,000 or 2,000 years ago. Does it really make sense for current policy to be dictated by plans established by someone living in the year 500? Yet that is precisely the situation that we are dictating for the future with perpetual charitable trusts.

Of course, this inquiry highlights the fundamental flaw of these perpetual entities. Namely, they are based on an assumption that the United States and its current system of laws will continue to exist in perpetuity. And yet, in the history of mankind, few empires have lasted even 1,000 years, let alone 10,000 or 100,000.

Meanwhile, there are serious consequences to this system that encourages saving for tomorrow (and the next century and next millennia) instead of spending for today. Real problems are not being adequately addressed. Environmental degradation, issues of war and peace, hunger, infectious diseases, education and multi-generational cycles of substance abuse and poverty are all issues that are in need of immediate resources. Yet, in pursuit of perpetuity, fewer resources are being devoted to these pressing issues.

Who benefits from this choice to direct charitable dollars to perpetual trusts instead of outright charitable gifts? The biggest beneficiaries are the trustees who are paid large trustee salaries and the supporting institutions, like banks and other financial services companies, who are paid fees for managing this accumulating wealth.

Many people are surprised to learn that people often receive payment for serving on the board of directors of private foundations, (particularly in light of the hundreds of thousands of less well off Americans who donate their time to serve on the boards of non-profit organizations). These fees can be substantial—it is not uncommon for a trustee of a private foundation to be paid \$100,000 annually. A 2003 study analyzing tax returns of 238 private foundations revealed that in a single year, these organizations spent nearly \$45 million on trustee fees—the bulk of which was paid to their own predominantly wealthy boards of directors. For some of these trusts, the money spent on trustee fees and other administrative expenses exceeded the amount spent on charitable endeavors.⁴⁰

In addition to trustees, the other beneficiaries of perpetual charitable trusts are banks and financial service companies. Assuming a modest one percent fee, the \$600 billion dollars that is currently in private foundations generates over \$6 billion in management fees every year. While perpetual charitable foundations may provide a bad deal for society, they provide inordinate benefits to the financial services industry in the form of perpetual management fees.

Despite these problems, perpetual charitable organizations continue to be the preferred format for charitable giving. When people establish charitable foundations, they most commonly do so in perpetuity. In a 2004 survey of private foundations, only nine percent of the respondents said that their foundation would not exist in perpetuity.⁴¹ This could be intentional on behalf of donors (an explicit desire to have their foundations address the problems of tomorrow as well as today), or perhaps it is because when they seek professional advice, the perpetual foundation is the one most likely to be presented to them. Regardless of the motivation, the results are undisputable—the vast majority of charitable foundations are established in perpetuity and American law does nothing to discourage this.

40. Christine Ahn et al., *Foundation Trustee Fees: Use and Abuse*, The Center for Public and Nonprofit Leadership, Georgetown Public Policy Institute (September 2003), http://cpnl.georgetown.edu/doc_pool/TrusteeFees.pdf.

41. Renée A. Irvin, *Endowments: Stable Largesse or Distortion of the Polity?*, 67 PUB. ADMIN. REV. 445, 445 (2007).

Nonetheless, there has been some notable and powerful dissent from the tide of perpetuities. When Warren Buffet committed to contribute roughly \$30 billion to the largest private foundation in existence—The Bill and Melinda Gates Foundation—he did so on the condition that none of the donations be added to principle and all of Buffet’s contributions be spent within one year of contribution.⁴² Moreover, the Gates Foundation itself recently amended its charter to provide that it would end within fifty years after the death of the last of its trustees, Bill Gates, Melinda Gates or Warren Buffet.

There are a number of ways in which the law could be revised to make private foundations less focused on their perpetual existence and more responsive to societal needs. First, the law could require (as was proposed in 2003) that the five percent minimum payout rules must be satisfied with transfers to charity and not trustee fees and other administrative expenses. This would discourage private foundations from spending such a significant portion of their annual expenditures on administrative expenses. More directly the tax law could provide explicit limitations on the duration of private foundations or could provide that donors do not get their charitable deduction until the money is actually transferred for charitable purpose. Regardless of the method chosen, until the law takes a more concerted step to discourage perpetuities, we can expect more charitable dollars to be committed to perpetuating their own existence rather than toward their stated charitable goals.

42. Buffet gave them ten years to disburse money from transfers made upon Buffet’s death. See Bill & Melinda Gates Foundation, *Implementing Warren Buffett’s Gift*, <http://www.gatesfoundation.org/about/pages/implementing-warren-buffetts-gift.aspx> (last visited Mar. 21, 2010).