TRENDS IN NONPROFIT CORPORATION LAW IN 1976

HOWARD L. OLECK*

The interest of most Americans in nonprofit, and especially in charitable, organization work has long been a notable feature of American society — having been remarked upon as early as the 1830's in Baron de Tocqueville’s analysis of American democracy. That tendency continues today, even in times of economic recession. The economic crunch of 1975-76 saw an increase, not a decrease, in American donations to charitable organizations: specifically, a 6.5 percent increase in charitable donations ($26.88 billion in 1975, compared to $25.23 billion in 1974), though contributions by foundations and businesses declined by 4.7 and 4 percent respectively. Religious charities were the prime recipients, taking 43.5 percent of the total ($11.68 billion); health related charities received 15 percent ($4.01 billion); education declined by 3.5 percent ($3.59 billion); social welfare agencies received $2.46 billion, with United Way campaigns raising over one billion dollars for the first time. At the same time, though no similar pecuniary data are available, there is no doubt that generally nonprofit (excluding charitable) organization activity, such as clubs and societies, continued to increase, while individual-hours devoted to business (profit) activity continued to decrease.

Today, probably over half of the formal organizations and enterprises in the United States are nonprofit in nature. The Corporation Division of the Secretary of State’s Office of Ohio, a typical state, reported that for every two business corporation charters in the active files, there is one

*Professor of Law, Wake Forest University School of Law; B.A., University of Iowa; J.D., New York Law School; LL.D., Baldwin-Wallace College; Litt. D., (Hon.), John Marshall University.

1 A. DE TOCQUEVILLE, DEMOCRACY IN AMERICA 196 (3d ed. 1946).
2 N.Y. Times, Mar. 6, 1975, at 28, col. 1 reported how neighborhood groups formed, almost spontaneously, to help unemployed and underprivileged persons in various areas of Seattle, Washington.
3 N.Y. Times, May 6, 1975, at 53, col. 6 reported that according to a report by the American Association of Fund Raising Counsel, Inc., over $25 billion was donated by Americans to charities in 1974, an increase of $1.7 billion (7.4 percent) over 1973. A total of $10.83 billion was contributed to religious organizations; $3.9 billion for health service (including hospitals); $3.72 billion for education; $2.34 billion for social welfare (including all United Way organizations); $1.28 billion for arts and humanities; $710 million for civic and public affairs; and $2.35 billion for others, including foreign aid. The total was more than double the $12.21 billion given ten years before.
4 H. OLECK, NON-PROFIT CORPORATIONS, ORGANIZATIONS, AND ASSOCIATIONS 1 (3d ed. 1974) [hereinafter cited as OLECK].
nonprofit corporation charter. On the other hand, an attempt to obtain similar information from the North Carolina Secretary of State's Office produced this reply from the Corporation Attorney in that office: "We have no figures on nonprofit corporations . . . ." Both reports are typical—the first of the actual proportions, and the second of the paucity of study on nonprofit organizations.

The Yellow Pages of any American telephone directory reveal astonishing (and ever-increasing) numbers of listings under classifications that indicate a nonprofit or charitable character (e.g., "Associations", "Chambers of Commerce", "Charities", "Clubs", "Foundations", "Fraternal Orders", "Hospitals", "Labor Unions", "Museums", "Schools and Colleges", "Social Service Organizations"). If one also includes "Governmental Offices", and considers that most voluntary organizations such as PTA's and local social and sports groups are unincorporated and rarely counted, the numbers of active nonprofit organizations become impressive indeed. It is axiomatic that Americans are the greatest "joiners" in the world. Thus, in 1975 there were 330,460 churches in the United States, with a membership of 131,245,000. The number of national associations rose from 10,299 in 1968 to 12,628 in 1973. The number surely is even greater in 1976.

Actually, these numbers are probably only a fraction of the real statistics. For example, as early as 1954, there were reportedly 12,000 trade associations (with four million members in existence) and this

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5 For details of statistic-approximation reports, see Oleck, supra note 4, ch. 1. In Ohio about half a million nonprofit corporation charters have been filed since records were first kept on this type in 1852.

6 Letter from Jack Styles, Corporation Attorney, Department of State, North Carolina to Howard Oleck, July 9, 1974. Mr. Styles added, however, that he ... [W]ould estimate that the number formed would be between 10 and 20 percent of the number for business corporations. Religious organizations, charitable organizations, and recreational organizations make up the great majority of these filings, but we also receive volunteer fire departments, rescue squads, emergency radio organizations, historical societies, labor and trade organizations, and numerous other types of nonprofit corporations, all filed under N.C. Gen. Stat. ch. 55A (1975). The files for nonprofit and business corporations contain at present approximately 200,000 documents. In addition, we file Mutual and Cooperative Association charters, North Carolina Bank Charters, North Carolina Insurance Company Charters, and numerous other types of corporation charters under various statutes . . . .

7 Schlesinger, Biography of a Nation of Joiners, 50 Am. Hist. Rev. 1, 19 (1944). For example, by 1900 over five million members belonged to over 70,000 local fraternal lodges. Today, of course, far more people belong to far more organizations.


9 Id. at 48.

10 See Webster, Associations and the IRS (Introduction) (1966), citing Judkins, Trade Associations in 1954 total 12,000, Trade Association World, January 1954.
number is even higher now. In membership associations, the American Automobile Association has 860 clubs today, with 16 million members. The Foundation Directory reports 26 foundations in 1970 with assets over $100 million, while the 1975 figures show that there are now 38 foundations with such wealth. Thus, despite an economic crunch and the passage of the Tax Reform Act of 1969, placing restrictions on foundations, these nonprofit institutions have flourished.

Nobody knows the numbers of unincorporated local groups such as PTA's, garden clubs, theatre groups, sewing circles, and the like, but they certainly are numerous everywhere in the United States. The influence of the nonprofit organization upon American society is tremendous.

Since World War II there has been a dramatic shift of emphasis, in the United States and elsewhere, from profit-oriented to public welfare-oriented matters. Indeed, the business corporation is viewed with distrust by many people, including many law students and law practitioners. A Louis Harris Survey in late 1975 showed that only 19 percent of Americans had much confidence in leaders of America's major corporations. This attitude has much to do with the growth in recent years of nonprofit public interest organizations such as Ralph Nader's Center for the Study of

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11 See WORLD ALMANAC 269 et seq. (1974) listing a few typical membership numbers of some typical associations and societies:

<table>
<thead>
<tr>
<th>Association</th>
<th>Members</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agricultural Chemicals Association</td>
<td>105</td>
</tr>
<tr>
<td>Air Force Association</td>
<td>110,000</td>
</tr>
<tr>
<td>Alcoholics Anonymous</td>
<td>650,000</td>
</tr>
<tr>
<td>AFL-CIO</td>
<td>13,500,000</td>
</tr>
<tr>
<td>American Legion</td>
<td>2,700,000</td>
</tr>
<tr>
<td>American Legion Auxiliary</td>
<td>942,000</td>
</tr>
<tr>
<td>Amateur Athletic Union of the United States</td>
<td>300,000</td>
</tr>
<tr>
<td>Audubon Society</td>
<td>261,327</td>
</tr>
<tr>
<td>American Bar Association</td>
<td>163,748</td>
</tr>
<tr>
<td>American Bowling Congress</td>
<td>4,047,596</td>
</tr>
<tr>
<td>Auto License Plate Collectors Association</td>
<td>1,462</td>
</tr>
</tbody>
</table>

12 CBS NEWS ALMANAC 878 (1976).


16 As to those who manage the most important of the nonprofit organizations, reference can be made to two main directories: ENCYCLOPEDIA OF ASSOCIATIONS (8th ed. 1973). Published by Gale Research Co. of Detroit, this is a two volume work listing management personnel and major policies. THE FOUNDATION DIRECTORY (5th ed. 1975). Published by Russell Sage Foundation, New York City, this directory lists management personnel and major policies of most of the major foundations, and is revised every few years.

17 See Oleck, Remedies for Abuses of Corporate Status, 9 WAKE FOR. L. REV. 463 (1973) [hereinafter cited as Remedies]. And the situation is worse in 1976. See almost any daily newspaper’s reports on the continuous disclosures about corporate bribery and corruption here and in foreign countries.

18 NEWSWEEK, Feb. 16, 1976, at 57.
Responsive Law and John Gardner's Common Cause (now with over 250,000 members). On the other hand, the influence of private clubs on society continues: a 1975 conference in New York City reported that racial, religious and sex attitudes and biases clearly affect employment opportunities of many people today, as many business deals are arranged in private clubs.

I. HUMAN NATURE: MAIN PROBLEM IN NONPROFIT ORGANIZATIONS

The collision between noble statements and not-so-noble deeds in 1976 continues to be the main problem in nonprofit organizations, as it has long been in almost all aspects of human society. Rights without duties and privileges without responsibilities are desired by almost everyone. But individual rights, and corporate ones, of course must be limited by the rights of others. Today, the balance between rights and duties in nonprofit organizations is being jeopardized for advocates for increases on each side of the scales of the legal status of such organizations.

Perhaps the most significant change in recent years has been the change in the tax-exempt status of nonprofit foundations. From a status of almost unquestioned tax-exempt privilege in the 1940's and 1950's (when the number of tax-free foundations leaped from about 250 to perhaps 50,000), American foundations in the 1960's and 1970's have been subject to much adverse criticism for their tax-exempt status. Criticism has been followed by the enactment of restrictive laws, particularly the Federal Tax Reform Act of 1969, and its subsequent amplification by Internal Revenue Service rules and regulations and parallel state law changes. This development undoubtedly has been part of the widespread public revulsion evidenced in the sixties and seventies against all corporate power and against alleged corporate social irresponsibility. Advocates argue vehemently with respect to the proper balance between corporate powers and privileges. Some have even suggested great increases in nonprofit organization privilege. Professor Peter A. Cumming, a Canadian scholar,
recently proposed that Canadian law\(^{25}\) be changed\(^{26}\) to provide that general gifts to charitable corporations become corporate assets “entirely free of trust law,”\(^{27}\) even though directors of business corporations are now generally viewed as fiduciaries of assets even in hard-boiled business affairs.

This proposal was inspired by the 1970 New York Not-For-Profit Corporations Act,\(^{28}\) drafted by the New York Joint Legislative Committee,\(^{29}\) which expressly legitimizes a mixture of profit and nonprofit purposes. That mixture, which this author has strongly criticized,\(^{30}\) obviously appeals to the apologists for authoritarian management, as was evidenced by its emulation by the new Pennsylvania Nonprofit Corporation Law of 1972,\(^{31}\) enacted even before the effects of the New York law had been tested. In 1975 and 1976, the California Law Revision Commission, busily engaged in drafting an entirely new nonprofit corporations statute for that state, for enactment in 1977, was greatly influenced by the New York statute, despite contrary suggestions (e.g., from this author who served, and is serving, as an unpaid consultant to that Commission). Also, the transfer of the American Bar Association’s Model Nonprofit Corporation Act concepts from business (profit-oriented) into nonprofit laws continued, despite the inherent contradiction in adopting profit-aimed rules for what should be altruistic organizations. On the other hand, governmental scrutiny of nonprofit organizations by the Internal Revenue Service, the Securities and Exchange Commission, and some state Secretary of State and/or Attorney General offices has greatly increased in the last two years. It is an ironic commentary on the trend that was started by the

\(^{25}\) See, e.g., Charities Accounting Act, CAN. REV. STAT. ch. 63, §1(2) (1970), which deems a charitable corporation to be a trustee within the meaning of that Act.

\(^{26}\) See PROPOSALS FOR A NEW NOT-FOR-PROFIT CORPORATION LAW FOR CANADA (1974). This is a two volume work published by the Canadian Ministry of Consumer and Corporate Affairs. The Proposals follow Bill C-213, An Act respecting Canadian business corporations, introduced in Canadian Parliament on July 18, 1973 by Hon. Herbert Gray, Minister of Consumer and Corporate Affairs. In a news release dated June 14, 1974, Mr. Gray estimated that Canada has about 34,300 tax-exempt organizations and about 10,000 nonprofit corporations, of which about 1,500 are federally incorporated social and charitable corporations.

\(^{27}\) Cumming, Corporate Law Reform and Canadian Not-for-Profit Corporations, 1 THE PHILANTHROPIST 10, 31 (1974).

\(^{28}\) N.Y. NOT-FOR-PROFIT CORP. LAW §201 (McKinney 1970).

\(^{29}\) Mr. Robert S. Lesher of Buffalo, N.Y. was Chief Counsel to this Committee. For his reasoning, see Lesher, The Non-Profit Corporation—A Neglected Stepchild Comes of Age, 22 BUS. LAW. 951 (1967).


\(^{31}\) See PA. STAT. ANN. tits. 9, 15, 22, 40, 42, 54, 67 (1973).
1970 New York statute, that it was not followed by an explosion of Class C (mixed charitable and profit) incorporations. The Internal Revenue Service and the courts construing tax privileges alike have been anything but warm in their views of such mixtures.32

One wonders how much impetus for the enactment of such permissive law came from millionaires or bank trust department directors. New York's statute states that trustees of Type B (charitable, educational, religious, cultural, and prevention-of-cruelty) corporations shall be deemed owners in effect, rather than trustees, of property received by the corporation.33 The "trustees" thus are not accountable to donors.34 There is little doubt what the average contributor to a charity would think of this new rule if he or she understood its ultimate meaning.

The authoritarian flavor that now tends to permeate modern nonprofit corporation statutes was further emphasized in 1974 by Supreme Court decisions that sustained almost dictatorial powers of the Internal Revenue Service over organizations claiming tax-exempt status.35 The tax code bars prior restraint by injunction against tax assessment or collection unless absolutely no governmental justification of the tax can be shown by the IRS.36 This means that an IRS refusal of the tax exemption, with the catastrophic consequences of such refusal for a nonprofit organization, can be challenged only by a protracted lawsuit that is a practical impossibility for most of these organizations. This harsh rule was reiterated by the court,37 despite a strong dissent by Justice Blackmun. It delays justice for applicants who need prompt decisions, and gives to IRS decisions "virtual plenipotentiary power over philanthropic organizations" that in effect usually make these decisions "fully insulated from challenge when effectu-

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32 At a two-day course on Non-Profit Corporation Management Law, held in late 1974 at Wake Forest University under the sponsorship of the American Law Institute (ABA Joint Committee of Continuing Legal Education), various experts commented that few (or no) such mixtures actually would be given tax-exemptions.

33 N.Y. NOT-FOR-PROFIT CORP. LAW §513 (McKinney 1970).

34 The alleged justification for this extraordinary rule is supposed to be the freeing of trustees to treat income as not part of the principal corpus of the trust. N.Y. NOT-FOR-PROFIT CORP. LAW 103(a) (McKinney 1970).

35 See cases cited note 37 infra.

36 INT. REV. CODE of 1954, §§401(c)(3), 7421(a).

ating social policy." This authoritarian power has been almost uniformly but futilely condemned by commentators.

Even so, the tendencies toward social welfare primacy in corporation law, especially in nonprofit corporation law, collide constantly with the "paternalistic" tradition. Thus, derivative actions by members now are allowed. Ordinary taxpayers are held to have standing to sue to enforce charitable trusts. However, state tax exemption, primarily property tax exemption, is becoming harder to get, or to keep, as the states constantly increase their appetites for tax monies.

Yet, the tendency of some public authorities to be amenable to nonprofit organizations is also strong. Interposition of interested parties, through use of amicus curiae briefs, is common. Members' inherent rights to belong to associations are strongly favored where the right to earn a living is involved. The cy pres rule still applies to preserve the rights of those intended to be benefited by grantors. Minority rights are favored on the one hand and overruled for "social architect purposes" on the other.

38 416 U.S. at 773 (Blackmun, J., dissenting). The same sentiments were expressed by former IRS Commissioner Randolf W. Thrower in his article, IRS Is Considering Far Reaching Changes in Ruling on Exempt Organizations, 34 J. TAXATION 168 (1971).


42 See People ex rel. County Collector v. Hopedale Medical Foundation, 46 Ill. 2d 450, 264 N.E.2d 4 (1970); State Board of Tax Comm'r's v. Fort Wayne Sport Club, Inc., 147 Ind. App. 129, 138-39, 258 N.E.2d 874, 881 (1970). See also N.Y. Times, Dec. 15, 1970, at 65, cols. 2-3 which reported that Jerry Rubin's Yippie "Social Education Foundation" did not qualify for tax exemption, as his wife was sole trustee and the foundation was used to further his private purposes.


47 See Mack v. Huston, 23 Ohio Misc. 121, 256 N.E.2d 271 (C.P. 1969), in which a church relinquished its assets to a "black caucus of members" over objections by other members.
II. PROPRIETARY MENTALITY

The core problem has consistently been the tendency of some people to pretend to have charitable purposes while seeking only, or primarily, personal advantage. Perhaps the ultimate in what I call "proprietary mentality of nonprofit corporation managers" is a 1974 North Carolina case, where a president of a charitable "Youth Camp" recreational program simply deeded 10 acres of the camp's land to his wife and daughter, without the knowledge of the trustees and for no consideration to the corporation.9

The universal nature of this problem is illustrated by the following comment in a letter to me from an English law professor, referring to my estimate in a law review article50 that at least half of all American nonprofit organizations are used for someone's personal profit:

I was particularly interested in your article in the January 1971 issue. I am not competent to comment in depth, on its content, but would second most wholeheartedly your conclusion at page 165, which tallies with my own experience. I was for many years with the [English] Department of Inland Revenue. Had it not been for the accruing tax advantages, the English Charitable Trust, would, like the Deed of Covenant, have died out long ago. In many cases, self-interest shows through to such an extent as to obscure entirely any incidental motive of a charitable nature behind the setting up of the foundation. I humbly join you in your cynicism.

The conclusion seems to be evident: The most important feature of any nonprofit organization, in 1976 as before, continues to be how it is managed in fact.51

III. MANAGEMENT'S GROWING PROBLEM OF "OUTSIDERS"

Of course, a nonprofit or profit corporation basically is free to govern itself. If it adopts lawful and reasonable rules, and follows them, courts and administrative agencies generally do not interfere.52

Until quite recently, there was little supervision of nonprofit corporations by government agencies and that is still true in many states. In North

9 See Mountain Top Youth Camp, Inc. v. Lyon, 20 N.C. App. 694, 202 S.E.2d 498 (1974). The transfer was declared by the court to be null and void, of course.


51 For a good summary of nonprofit organizations' legal criteria for by-laws and control by members' meetings and voting, see Potter v. Patee, 493 S.W.2d 58 (Mo. App. 1973).

Carolina, for example, the Corporations Division of the Department of the Secretary of State in 1974 consisted of one Corporations Attorney and a clerical staff of five persons. This one attorney supervised all corporations, both business and nonprofit. In Ohio, a similarly tiny state administrative structure (one Assistant Secretary for thousands of nonprofit corporations) was founded in 1971 though that state had probably 50,000 active nonprofit corporations on file. New York and California seem to have led the way in increasing their state supervision by 1970, using five to seven attorneys and four or five accountants for their respective Corporation Division Offices, but, of course, both states already had vast numbers of nonprofit corporations.

In 1976, according to a statement by the Ohio Attorney General, there were 33 states that required annual reports by charitable trusts and foundations, but only nine had adequate funds or staffs for effective regulatory work. Ohio registers 100 to 150 new charitable trusts per year, and continues to fall behind in supervision. However, Ohio gives wide discretion to its Secretary of State in granting or denying charters. New York, by comparison, limits that discretionary power, and has set guidelines for this purpose in 1975.

In 1976, according to a survey made by Richard Manger, a third year student at Wake Forest University School of Law, the Massachusetts Attorney General’s Public Charities Division had a staff of 14 (including four attorneys) supervising about 11,000 charities with assets of hundreds of millions of dollars. Ohio has a staff of 23 in its Charitable Foundations Section, handling some two thousand trusts with aggregate assets of 2.1 billion dollars. The staff includes nine attorneys, four accountants, and three investigators—a big increase in supervision as compared with data

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53 Letter from Jack Styles to Howard Oleck, July 9, 1974. See note 6 and accompanying text supra.
54 See Oleck, Nature of American Non-Profit Organizations, 17 N.Y.L.F. 1066-67 (1972) for data from the Ohio Secretary of State.
56 Letter from William Brown, Ohio Attorney General, to William Manger, third year law student at Wake Forest University, Apr. 9, 1976.
of earlier years, with the increase expected to continue in 1976. By comparison, Arizona had no statutes in 1976 providing for supervision of nonprofit organizations, nor did its attorney general have common law functions requiring such supervision. Some states actually forbid release of data to private citizens making inquiry. Ohio in 1975 enacted legislation empowering the attorney general to request information in investigations of charitable trusts. Overall supervision is increasing nationwide.

In 1974, Congress reorganized the IRS administrative structure to provide an Assistant Commissioner with a staff of 20 employees to supervise the tax-exempt qualification of organizations, compute taxes on unrelated business income, and promulgate rules with respect to private foundations and employee pension plans. The office is funded by half of the private foundations investment tax collections plus an annual appropriation of $30 million.

Nonprofit organization management faces a moral dilemma in resisting temptation, because of the well-known absence of the likelihood of governmental attention. An ironic factor in the prevention of greater abuse of privilege, in this respect, is the check imposed by self-interest that fears loss of privilege if abuse becomes flagrant.

On the other hand, intrusions into organization affairs by interested parties (or, "outsiders" or "busybodies"—depending on one's point of view) is a growing problem for nonprofit organization management. Thus, derivative actions by members of nonprofit as well as of business corporations now are allowed. Ordinary taxpayers are held to have standing to sue to enforce charitable trusts, and whole organizations devoted to questioning the conduct of corporation management have become active in recent years, as a part of the crescendo of distrust of all corporations. Offers of amicus curiae briefs by "outsiders" in corporate disputes are frequent. Collisions

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61 Letters to Mr. Manger from Kentucky and Wyoming Attorney General's Offices, Mar. 24 and Mar. 19, 1976 respectively.
63 INT. REV. CODE of 1954, §7802(b); P-H TAX-EXEMPT ORGANIZATIONS ¶29,001 (1974).
64 See, e.g., In re Troy, 300 N.E.2d 159, 180-84 (Mass. 1973); See also E.W. Morris, Public Charities: Maintaining Their Favored Public Status, 11 N.Y.U. CONFERENCE CHARITABLE FOUNDATION 179-301 (1973).
65 See note 40 and accompanying text supra.
66 See cases cited note 41 supra.
67 Remedies, supra note 17, at 473.
68 See note 44 and accompanying text supra.
between good management principles and demands for "social engineering" by nonprofit corporations are frequent. 69

Political intrusions (i.e., by politicians, rather than of political issues) reached a shocking extreme in the undeniable interference by the White House in the tax exemption application of the Center on Corporate Responsibility in 1973.70 The Internal Revenue Service had to be ordered by a court to ignore White House objection to the granting of an exemption to which the organization clearly was entitled. This startling case is viewed by some as a manifestation of the conception of business corporation management as unquestionable aristocracy. Another questionable IRS ruling was one issued about October 26, 1974, as a private ruling,71 that a "public interest law firm", Public Advocates of San Francisco, may accept only up to fifty percent of fees awarded by a court or public agency and still maintain its tax-exempt status, though such limitation is not placed on any other tax-exempt group. A firm spokesman, formerly an IRS lawyer, said this ruling would force public interest firms to depend on foundations' largesse, though all IRS staff members had recommended that firms be allowed to keep one hundred percent of court awarded fees. He said the ruling was motivated by the fact that Nixon political appointees to the IRS are opposed to public interest law firms.

In Alyeska Pipeline Service Co. v. Wilderness Society,72 a 5-2 Supreme Court decision, the Court denied the federal courts the power to assess attorney's fees against a party to a suit, solely upon a determination of the social value of the successful plaintiff's suit. The Court held that under the "American Rule", attorney's fees ordinarily are not recoverable by the winning litigant in federal courts unless a specific statute authorizes the award of such fees.73 Attorney's fees, however, are allowed in the exceptions to the "American Rule"74 where a "common fund" is established, or where oppression is shown,75 or willful disobedience of a court order is shown.76 The Alyeska case had a chilling effect on public interest lawsuits and

69 Oleck, supra note 50, at 165.
73 Id. at 267-68.
organizations, but by no means a fatal effect on them as of 1976. State courts, such as New York, now tend to affirm a citizen's standing to sue in asserting his interest in government. 

IV. TAX EXEMPTION LAW TRENDS

Property tax exemptions have been dwindling in all parts of the country. This development poses hard questions for nonprofit organization management. With one stroke the corporate assets and income and income-inducing status are all reduced. A typical recent case held "not charitable" and thus not tax-exempt, the operation of a medical office building by a charitable hospital for the convenience of the private practice of its staff members. If management cannot offer inducements to needed staff, how can it operate the charity effectively? Even fraternal orders and bar associations have been held to be not primarily charitable or educational, and so not tax-free. Under the Tax Reform Act, the cost of goods or services supplied to members is not deductible. This is only one illustration of the varied pressures of tax law on nonprofit organizations.

Tax exemption is, of course, a key facet in the operation of nonprofit organizations. Often it is only the exemption that makes feasible some highly desirable nonprofit organization activities. But when, as in New York, tax exemption has increased to a third of the assessed valuations in that city (and state, as well), and the proportion is expected to be one-half by 1985, the trend simply must be reversed. That is why the New York Legislature in 1971 permitted cities to restore to their tax rolls all property

except that "used exclusively for religious, charitable, hospital, educational, moral or mental improvement of men, women and children." Nevertheless (or, because of this), in July 1974, the New York high court ordered tax exemption (ended in 1971) restored to property in New York City owned by the Watchtower Bible and Tract Society, known as Jehovah's Witnesses. In a unanimous opinion, the court ruled that the organization "is organized and conducted exclusively for religious purposes within the meaning of the statute." In December 1974, the Cleveland, Ohio City Council ordered that all charitable organizations (private school, etc.) must pay for water supply, which previously they had gotten free, while suburban organizations were put on notice that they soon would also have to pay for city water supply.

*Walz v. Tax Commission*, probably the key Supreme Court tax law decision of 1970, though referring to First Amendment grounds, held that a grant of tax exemption is a most benign form of state involvement, but it is not enough to be called a subsidy (which would be improper), even though it does operate as an indirect benefit.

IRS views are such that if an organization fails to meet even one of the various requirements for tax-exempt status, it will lose its tax exemption. Political or propaganda activity was very likely to cause IRS wrath in 1976. It was likely to lead to classification by the IRS as an "action organization," with loss of tax-exempt status. But the "20 percent test" of such activity has been held to be too mechanical to be determinative henceforth. Tax incentives for needed social services, such as low rent urban housing, seem to be favored in recent years. Similarly, a municipal tax on a government-granted leasehold for a needed restaurant on a

83 N.Y. REAL PROP. Tax Law §421 (1)(b) (McKinney 1972).
85 Id. at 99, 315 N.E.2d at 804, 358 N.Y.S.2d at 761.
86 N.Y. Times, Dec. 8, 1974, at 70.
90 Treas. Reg. §1.501(c)-1(c) (1976).
government turnpike was overturned, and the courts have continued to be very hesitant to overturn religious organization tax exemption.

V. NONPROFIT ORGANIZATION OFFICER STATUS: TRUSTEES OR AGENTS?

More so than in business corporations, management personnel in nonprofit corporations are unsure whether they are agents, directors, trustees, officers, employees, or what. Case and statute descriptions speak of them in any or all of these terms, or speak of them vaguely as being in a "fiduciary relationship". The English and early American rule clearly viewed even business corporation directors as trustees, but this impractical rule was not retained for business corporations. The fiduciary duties of trustees, agents, directors, and partners are different in different situations. A seemingly clarifying, but eyebrow-lifting statement, from Section 1702.34(A) of the Ohio Non-Profit Corporation law states: "Unless the articles or regulations otherwise provide, none of the officers of the corporation need be a trustee." Although this section of the Code, on its face, merely outlines the structure and authority of corporate management, the above-quoted language from that section would certainly suggest that management of nonprofit corporations need not be bound by fiduciary obligations. As is usually true, people continue to enjoy the status and authority of holding the office of trustee, but do not relish adherence to the standards of selflessness and responsibility which that office requires.

Contributors to charities usually view their gifts as "in trust" for the


See North Dakota Conference Ass'n v. Board of Comm'r's, 234 N.W.2d 912 (N.D. 1975).


See summary in N. LATTIN, R. JENNINGS & R. BUXBAUM, supra note 97, at 621. See also L. BRANDIES, OTHER PEOPLE'S MONEY 35 (2d ed. 1933); Wadmond, Conflicts of Business Interests, 17 BUS. LAW. 48 (1961).

stated charitable purpose. But trustees naturally desire freedom of discretion in management of charitable corporation assets. New York's statute allows trustees of Type B (charitable, educational, religious, cultural, and prevention-of-cruelty corporations) to be owners in effect (i.e., not accountable as trustees) of property received by the corporation. This unaccountability to donors is said to be intended to allow to trustees more freedom of action in divorcing income from the principal of the trust.

The Uniform Management of Institutional Funds Act attempts to deal with this problem. It was approved and recommended for enactment in all states by the National Conference of Commissioners on Uniform State Laws in 1972. It changes the "prudent man rule" of trust investments, under which principal and income always had to be kept separate. The new Act allows the "total return" concept of investments, at least as to corporate funds clearly not held in trust.

VI. CIVIL RIGHTS AND NONPROFIT ORGANIZATIONS

The Civil Rights Act of 1964 declared a national policy to protect individuals in almost any kind of public relationship. Racial and religious bias were frowned upon by the courts, and were challenged strongly in the late sixties and early seventies. This view was applied to private organizations as well as to others, with the courts tending to see state action and violation of equal protection when discriminatory practices were proven. Similarly, freedom of association was protected by the courts, but the right of delectus personae was protected too, and private club arrangements were not often attacked, being specifically protected by the Civil Rights Act. Refinement of the private as against the public organization concept has been erratic and confusing.

The development of more conservative tendencies in the Supreme Court in the past two or three years has affected, but has not eliminated the protections referred to above. Private clubs continue to be held exempt

103 Id. §103(a).
(as long as they are private) from the duty to obey civil rights laws. Refusal of a state liquor license to a discriminatory club was held to be not “state action.” The right of such clubs to discriminate in admission policies and practices is uncertain. A private individual or institution may discriminate on racial or religious lines, absent significant state involvement, according to Moose Lodge v. Irvis, a 1972 Supreme Court decision. What is state action is an unsettled constitutional question. It would be hard to exaggerate the impact of civil rights law on such organizations as labor unions, civil groups, and other, but cataclysmic is the word for their effect on social clubs and similar organizations. The very essence of the idea of a club or fraternity or sorority is delectus personae, choice of the persons with whom one wishes to associate. Law may force people to be reasonably polite to each other. It does not seem to be effective in making them love each other. Nevertheless, the Defunis v. Odegaard case in 1974 seemed to say that affirmative action to guarantee civil rights is here to stay for a while at least, despite its clear resemblance to state action.

Where the right to earn a living is involved, the rights of members or candidates have been consistently protected in professional societies, labor unions, and trade associations. Indeed, antitrust problems now are becoming highly visible in trade associations. The boundaries of proper

109 See Tillman v. Wheaton-Haven Recreation Ass’n, 451 F.2d 1211 (4th Cir. 1971), rev’d and remanded, 410 U.S. 431 (1973). On remand, the court found that the corporate directors who knowingly voted for discriminatory policies were personally liable for damages under 42 U.S.C. §1981-82 even though they were ignorant of the full consequences of the applicable law and had been wrongly advised by their attorneys. 517 F.2d 1141 (4th Cir. 1975), aff’g and modifying, 367 F. Supp. 860 (D. Md. 1973).
110 See Note, 41 FORDHAM L. REV. 695 (1973); Note, 7 SUFFOLK U. L. REV. 1069 (1973); Note, 23 SYRACUSE L. REV. 905 (1972). In mid-1974, the U.S. Second Circuit ordered a New York District Court to try a case charging that action by a foundation was racially discriminatory, and that its tax exemption amounted to “state action”. Jackson v. Statler Foundation, 496 F.2d 623 (2d Cir. 1974).
propaganda activity or other political action of nonprofit organizations continue to be uncertain. The loss (or in a few states the continuation) of charitable immunity for the torts of agents or organizations continues to be a headache, and is still being argued in the courts. \( ^{117} \) \textit{Cornellius v. Benevolent Protective Order of Elks} \( ^{118} \) is a good illustration of the standards (tests) of proper private club provisions (e.g., selectiveness, procedures, internal controls, history, non-members’ relations to it, dues, advertising, profit motives).

VII. PROPER AND IMPROPER MANAGEMENT PRACTICES

The case decisions have been confusing on the question of proper conduct of managers of nonprofit organizations. For example, a decision to change a college curriculum was attacked as a breach of contract, though the university trustees finally were upheld by the Ohio court. \( ^{119} \) On the other hand, the powers of a nonprofit corporation president to deal with assets were quite narrowly limited by a North Carolina appeals decision. \( ^{120} \)

The various limits and overall scope of charitable conduct continues to be analyzed by the courts—and not only in property tax exemption disputes. Test elements of charitable classification were spelled out recently in a Massachusetts decision involving use of a charitable corporation as a personal profit instrumentality for real property ownership. \( ^{121} \)

First Amendment protection of unorthodox statements by a member (a teacher) of a not-for-profit organization as to scientific and religious matters, was reaffirmed recently in a North Carolina district court decision. \( ^{122} \) Though this case involved a county board of education, its equal relevance to private organizations is obvious. What questions properly may, or may not, be asked of an applicant for admission (e.g., to law


\( ^{118} \) 382 F. Supp. 1182 (D. Conn. 1974).

\( ^{119} \) See Sternberg v. Board of Trustees of Kent State Univ., 37 Ohio St. 2d 115, 308 N.E.2d 457 (1974).

\( ^{120} \) See Mountain Top Youth Camp, Inc. v. Lyon, 20 N.C. App. 694, 202 S.E.2d 498 (1974).

\( ^{121} \) See In re Troy, 300 N.E.2d 159, 180-84 (Mass. 1973).

school) were discussed in a recent Ohio case.\textsuperscript{123} This is a far cry from the old-fashioned absolute setting of admission rules by managers of nonprofit organizations of the past.

Further ramification regarding proper management conduct is shown by the following examples:

(1) Administrators of a college recently were lectured by a New York Court as to their duty (or right) to suppress offensive student publications,\textsuperscript{124} while the U.S. Supreme Court upheld the right of a Missouri student to use foul or obscene language, despite objection by the school.\textsuperscript{125}

(2) The mere fact that others had made gifts to a charitable corporation (hospital) in Florida recently was held to be not enough consideration to make enforceable a pledge by one who then did not contribute as promised.\textsuperscript{126}

(3) Reverse racial discrimination by a black-teachers' association, and the double nature of \textit{delectus personae}, were treated as objectionable and unlawful in a New York federal district court decision.\textsuperscript{127}

(4) North Carolina held recently that taxation to finance private charitable (hospital) facilities is unconstitutional.\textsuperscript{128}

(5) An Illinois association was upheld in providing in its participation agreements (for auto racers) for a release in advance of the organization from tort liability.\textsuperscript{129}

(6) Federal agencies were recently admonished by a New York appellate court that their regulations in funding public welfare services must not tie the hands (or freedom of discretion) of nonprofit organization management.\textsuperscript{130} How effective this lecture will be is left to your imagination.

(7) Charging of a fee to beneficiaries of a charity (a "home") was

\textsuperscript{123} See In re Spott, 34 Ohio St. 2d 241, 298 N.E.2d 148 (1973).
\textsuperscript{125} See Papish v. Board of Curators of the Univ. of Missouri, 410 U.S. 667 (1973).
\textsuperscript{129} See Morrow v. Auto Championship Racing Ass'n, 8 Ill. App. 3d 682, 291 N.E.2d 30 (1972).
said to be likely to end the tax exemption of a Kansas charitable corporation. But the court did not offer to help the management to raise money with which to operate the home.

(8) It is little wonder that competition between organizations for the contributor's dollar, in this period of economic crunch, leads to battles between them for funds, and to court decisions forbidding confusion of names or "drives," as happened in a recent North Carolina case. An Illinois museum's management recently was held liable in damages for an assault on a child by other children, as though the management of a museum must guarantee the social decency of children while the state need not do so.

(9) An Illinois museum's management recently was held liable in damages for an assault on a child by other children, as though the management of a museum must guarantee the social decency of children while the state need not do so.

(10) A "warning bell" kind of decision—as to attorneys for corporations of all kinds—is an Illinois case discussing the tests of an attorney's personal liability for fraud perpetrated by his corporate client. Another such ruling is a Missouri case discussing the bases for recovery, by corporate members, of excessive salaries received by their corporation's officers. And the third is a clear declaration of an Illinois court that an unincorporated association may be treated as a corporation in order to hold it responsible and subject to court control.

VIII. FEDERAL COURT INTERPOSITION TRENDS

Besides the Civil Rights trends, the changing composition of the Supreme Court has been accompanied by a marked decrease in support of interposition by federal courts in internal operations of nonprofit corporations. Thus, in 1975, a federal court held that federal financial assistance to a private hospital was not state action and thus refused to enjoin the hospital's policy as to elective abortions. Nor was it "state action" to charter a veterans' association that excludes women.


136 See Boozer v. Local 457, UAW, 4 Ill. App. 3d 611, 279 N.E.2d 428 (1972). But see McDonald v. McDonald, 53 Wis. 2d 371, 192 N.W.2d 903 (1972) (partnership law will be applied to an incorporated partnership when that will produce a just result).

137 See Greco v. Orange Memorial Hosp., 513 F.2d 873 (5th Cir. 1975).

The trend seems to continue, however, to place individual rights (e.g., not to be a member) as against corporate rights to encompass (and hold) members, particularly in schools.\(^{139}\)

**IX. MANAGEMENT’S GROWINGLY DEFENSIVE MENTALITY**

All of the foregoing serves to indicate the troubled situation of both business and nonprofit corporate management today. Management is attacked by many persons and groups as irresponsible or grasping.\(^{140}\) Corporate officers’ personal liability for fraud, for instance, now is undoubted when the officer’s participation is clear.\(^{141}\)

A kind of malpractice liability insurance has been developed, to meet this situation.\(^{142}\) Directors’ and officers’ liability insurance is now a significant new specialty area in the insurance business. This kind of insurance was introduced only about ten years ago. Its utility is illustrated by the following table on the number of lawsuits against corporate officers and directors (of profit and nonprofit corporations) filed in federal district courts alone.\(^{143}\) It showed a general doubling of some categories of lawsuits in the past few years:

<table>
<thead>
<tr>
<th>Type of Case</th>
<th>1966</th>
<th>1968</th>
<th>1972</th>
</tr>
</thead>
<tbody>
<tr>
<td>Antitrust</td>
<td>480</td>
<td></td>
<td>1,379</td>
</tr>
<tr>
<td>Environmental</td>
<td>42</td>
<td></td>
<td>268</td>
</tr>
<tr>
<td>Labor Law</td>
<td>3,336</td>
<td></td>
<td>4,987</td>
</tr>
<tr>
<td>Patent</td>
<td></td>
<td>1,829</td>
<td>2,194</td>
</tr>
<tr>
<td>Securities</td>
<td></td>
<td>689</td>
<td>1,919</td>
</tr>
</tbody>
</table>

The statistics in 1975 and 1976 are higher, as any daily newspaper will show today.

Naturally, the nation’s charities are feeling the economic pinch of the current inflation. Few face disaster, but many are faced by reluctant potential donors who are squeezed by inflation, stung by higher costs, shaken by lower stock values, and seemingly afflicted by cynicism. More permissive

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140 See Remedies, supra note 17.
142 For an interesting short treatment of this problem and its insurance coverage, a recently issued pamphlet is available from Stewart, Smith Co., 116 John Street, New York, N.Y. 10038.
143 Fortune, April 1973, at 64.
arrangements are being used—pledge now, pay later. Ford Foundation reported in October 1974 that its assets had shrunk one-third in Wall Street's bear market.

"We have no answer for it" said John J. Schwartz, President of the American Association of Fund Raising Counsel. The big gifts are the ones suffering most, not the small contributions. Stock value drops have reduced the holdings-value of some groups by serious amounts. Costs are up and less can be done with cheap money. Hopefully, this will be only a temporary embarrassment.

On a more optimistic note, a survey among the nation's business companies showed contributions of $144 million to organizations for the arts alone in 1973, with plans to give as much or more that year, with museums and symphony societies the largest beneficiaries.\textsuperscript{144}

Management now expects (and gets) intense scrutiny not only by members but by outside public interest groups.\textsuperscript{145} Sale of shares in lawsuits against managers was approved in 1976 by a federal district court in New York.\textsuperscript{146} There is even a company selling shares in a business of bringing such lawsuits.\textsuperscript{147} Federal chartering of big corporations is being urged by many people.\textsuperscript{148}

Finally, an upturn (7.3 percent increase) in contributions to charities began in 1975, and apparently is still continuing.\textsuperscript{149} It does seem, in 1976, that American dedication to public service, nonprofit, cooperative work is still strong and healthy despite the economic difficulties of the time.

\textsuperscript{145} See C. D. Stone, Where the Law Ends (1976).
\textsuperscript{147} Public Equity Corp., Mt. Kisco, N.Y.
\textsuperscript{149} N.Y. Times, May 6, 1975, at 53, col. 6.