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RESPONSE

"FOR PROFIT CHARITY": NOT QUITE READY FOR PRIME TIME

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FOR-PROFIT charity is an intriguing idea.[1] At a high level abstraction it is already proving useful. For-profit entrepreneurs and investors often consider the broader social impact of their work, evaluating projects in terms of social returns as well as investment returns.[2] On the nonprofit side, the concept encourages firms to use incentive compensation to reduce managerial slack and to inject a dose of accountability into a sector that needs it.[3] But as a *tax* concept—that is, as a category of firms exempt from tax—"for-profit charity" might be unworkable, at least in the form suggested by Professors Malani and Posner.

The chief problem I have with eliminating the nondistribution constraint is the administrative nightmare of relying solely on Section 501(c)(3) to distinguish between charitable and noncharitable activities. Professors Malani and Posner propose that we allow any

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[1] This piece is a response to Anup Malani and Eric A. Posner, The Case for For-Profit Charities, 93 Va. L. Rev. 2017 (2007).

[2] See Darian M. Ibrahim, The (Not So) Puzzling Behavior of Angel Investors 4 (May 1, 2007), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=984899 (describing some angel investors as engaged in "for-profit philanthropy").

[3] See Peter Panepento & Ian Wilhelm, Bonuses for Top Nonprofit Officials Are Growing Quickly in Size, Chron. of Philanthropy, Sept. 20, 2007, available at http://www.philanthropy.com/free/articles/v19/i23/23003601.htm.

company to enjoy the tax breaks associated with charities, regardless of whether they distribute residual profits to founders, donors, or managers, so long as the company fits within the broad language of Section 501(c)(3). Without the nondistribution constraint, however, my concern is that we would see a flood of companies that currently pay taxes—for example, biotech and cleantech startups engaged in "scientific" activities or web companies engaged in "literary" activities—attempting to qualify as charities.

My point is not just that Internal Revenue Service employees will have to spend a lot of time reviewing paperwork. Rather, it is that Posner and Malani may place too much faith in the ability of Section 501(c)(3) to distinguish between charitable and noncharitable activities. If furthering private benefit does not disqualify a firm from nonprofit status, then I am not sure we have a reliable, principled method of distinguishing a charitable endeavor from any other business. Malani and Posner suggest that we could avoid this problem by revising Section 501(c)(3) to eliminate ambiguity over the definition of charity.[4] How exactly would we do that? What makes a charity a charity?

Posner and Malani's proposal thus needs to be fleshed out on this point before it can be considered as a serious legislative proposal. Under current law, the nondistribution constraint performs much of the heavy lifting in sorting out charitable and noncharitable firms. To make their proposal viable, we need to know more about why we choose to subsidize certain activities through the charitable tax provisions. Only then can we redraft Section 501(c)(3) accordingly.

The good news is that we need not adopt a radical legislative change to enjoy many of the benefits of the concept of for-profit charity. When a corporation like Google pours money into a "dot org" subsidiary, those subsidiary's operating losses can be used to offset taxable income from other profitable subsidiaries. Assuming the dot org subsidiary is part of Google's consolidated return, an investment in the dot org subsidiary produces a tax result nearly as beneficial as a charitable donation.[5] To the extent Posner and Malani's proposal is appealing in the real world—and I think might

[4] See Malani & Posner, supra note 1, at 2054.

[5] To the extent charitable expenses are capitalized into depreciable assets in the subsidiary, the tax benefits would be deferred in part.

be—we will see it flourish first through "charitable" subsidiaries of for-profit corporations.

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