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**TAX IMMUNITY FOR CHARITABLE ENTITIES: A COMPARISON
BETWEEN BRAZILIAN AND UNITED STATES SYSTEM.**

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ABSTRACT: This work aims to analyze the exemption of philanthropic organizations in the USA and the tax immunity of Brazilian philanthropic entities.

KEY WORDS: Taxation, tax immunity, exemption and philanthropy.

1. Introduction.

First of all, tax benefit of Brazilian charitable, educational or social assistance entities is a Constitutional issue, called tax immunity, while the equivalent benefit for nonprofit organizations in the USA is treated under the Law, and this is called exemption.

Brazilian charitable, educational or social assistance entities may enjoy tax immunity for their assets, income and services in cases under the conditions set forth in art. 14, Brazilian Tax Code, are met: That is, they do not distribute any parcel of their assets or their income; fully invest their resources in the country, while keeping their institutional objectives; and keep the book entries of their income and expenses in ledgers, in compliance with the formalities needed to ensure their accuracy. Again, in Brazil, this kind of exemption is a constitutional matter.

To be tax-exempt according to the US Internal Revenue Code, an organization must be organized and operated exclusively for exempt purposes, and none of its earnings may inure to any private shareholder or individual. In addition, it may not be an action organization, i.e., it may not attempt to influence legislation as a substantial part of its activities and it may not participate in any campaign activity for or against political candidates.

The Brazilian educational or social assistance institutions rendering services for which they have been set up, or placing them at the disposal of the population in general, devoid of any for-profit purposes are deemed tax immune.

The problem is that regarding social security contributions, the Brazilian institutions will be exempt, under the law, not immune, as long as they meet the additional requirements established in the Law, to wit: be recognized as of public utility; hold a Charitable Entity Certificate and Registration; freely promote charitable social assistance to needy persons; its directors, counselors, members, institutors or benefits under any circumstances; fully invest their possible maintenance and development results towards their institutional objectives.

The Brazilian charitable institutions tax model does not produce the desired effects, on account of its inefficiency, or by lack of reasonability of legal requirements for the securing of immunity and exemption.

The current work bears a comparison between the Brazilian charitable

institutions tax model and the North-American, in view of the fact that the latter comprises an example of tax efficiency and adherence to the system.

2. A Historical Comparison.

2.1 Different by Essence.

Even aware that performing a historical analysis comprises a hard and perilous task, either by sinning for superficiality or by the use of second-hand data, I wish to use the device taught by Umberto Eco, of climbing onto the shoulders of a giant so that we find ourselves at a higher threshold when discoursing on the issue.¹

The facts occurring in the British Colonies in North America, on December 16th, 1773, have marked the history of taxation and the idea of the North American nation itself, on the day known as the “Boston Tea Party”. The New England colonists destroyed a valuable shipment of tea from the *British East India Co.*, in protest against an Act of Parliament which had set up a tax on the tea exported to the American colonies. In retaliation, Parliament imposed several punitive measures, which the colonists dubbed “Intolerable Laws”. One of these measures was the closing of Boston Harbor until an indemnification, for the tea destroyed had been paid. This was the most important fact in a series of “pre-revolutionary events” which culminated in the USA Declaration of Independence, on July 4th, 1776. In their revolt, the colonists invoked a principle created by the British themselves during their long history of disputes between the king and the Parliament: the principle of “*no taxation without representation*”. That is, as the colonists had no representation in the London parliament, they would not be obliged to accept taxes created by it.

Thus, levying taxes is one of the visible, and resented, forms of the “colonial exploitation”. By raising taxes, the British metropolis triggered a series of events which, if they did not represent the cause, they triggered the American declaration of independence.

Master Alberto Nogueira posits that there was, in the United States of

¹ Eco, Umberto. How to make up a thesis. Eco explains that one should use a competent and renowned author as a support for the writer to raise his initial point and knowledge, starting from a higher threshold, that is, climbing onto the back of a giant.

America, almost consent by the American colonies on the taxation model presented by the pragmatic British.² This produced cultural roots which lead to the contest, by citizens, of measures deemed arbitrary regarding taxation.

The struggle between the federal legislation, copied from the British legislation, and the local legislations, cost legislation and a set of institutions which have allowed for integrating the great majority of activities to the formal legal system, so that the activities may be turned into capital and, consequently, into taxes³.

Quite unlike Brazil, an exploitation colony, in which everything had been imposed by the Portuguese colonists, without any consultation to the colony, thereby producing certain leniency toward the arbitrary state taxation.

In Brazilian history, since mid-18th century, the production of panned gold from the Captaincy had been decreasing. The Portuguese Crown, however, suspected that the fall in tax collection was more due to fraud than to production decline. It then decided that *“the annual income of the quintile should be 100 bushels. Whatever was missing to fulfill this total would be taken down and paid, anyhow, when the king so deemed, by a village arbitrarily chosen, and by surprise, to prevent riots. This was widespread taxation, which so much scared the population of the Minas Captaincy”*⁴

The conspiracy in the Minas Captaincy was the starting point in the contest of the colonial pact. Notwithstanding the personal motivations of each participant, no doubt remains that colonial exploitation had in high taxes its most evident face.

Currently, in an organized and democratic state, resistance to payment of taxes takes on less drastic forms than those which led to the events reported.

² Nogueira, Alberto. *Teoria dos Princípios Constitucionais Tributários*: Renovar, 2008. The author states that, in the United States of America as from the Declaration of Independence, in 1776, and the War of Independence, the trigger of the revolt against taxation was the institution of a tea tax, that is, it was the British Crown intent to levy a tax without the colonists' approval, because it was a practice that, any imposition within the British standards, taxes could only be demanded with prior consentment. America was then able to develop, by invoking the British doctrine, in the sense that the British laws were also the American laws, the basis for the war of liberation.

³ The First Latin America Business Summit was held in Rio de Janeiro, promoted by the World Economic Forum. Frédéric Sicre, the organization's managing director, listed among the main Brazilian, problems criminality, low efficiency of police forces and the Judiciary, low efficiency in tax collection and the problems related to property rights. The property issue came up in the debates on the hindrances to the development in Brazil. It is convenient to remember Hernando De Soto's book, *“The Mystery of Capital”* – Why capitalism works out in developed countries and fails in the rest of the world.

⁴ Alencar, Carpi and Ribeiro, 1981, p. 74.

However, not even civil disobedience, the most extreme form of resistance in a state of law, can be discarded, as seen in the state of California, USA, in a recent past.

The most common circumstance is for resistance to occur in a disguised manner. That is passive resistance, although of extreme efficacy. There are gross forms to avoid paying taxes – tax fraud – and sophisticated ways, like tax avoidance, which is done through “tax planning”. The results are the same, albeit the first being a crime and the second the use of loopholes in the law.

Now, after passing the bill which changes American’s health system, the government has suffered a huge resistance against the new law. One of the mainly groups is the “Tea Party” activists, which insist that government will pay for passing the health care reform. The name of the group dates back to the times before independence.

Instead of being discouraged by the passage of health care reform, Tea Party activists across the country say the defeat is a rallying cry that makes them more focused than ever on voting out any lawmaker who supported the measure. The whole Tea Party movement started because they are about smaller government and less spending and less taxes.

Attorneys general from 13 states sued the federal government, claiming the landmark health care overhaul is unconstitutional just seven minutes after President Obama signed into law. They said that the Constitution nowhere authorizes the United States to mandate that all citizens and legal residents have qualifying health care coverage.

In spite of American’s legal experts say the suit has little chance of success, this kind of movement shows how strong is the struggle against any change which involves the tax system.

No matter what form of resistance one uses, the latter shall be as intense as the tax burden. Gross tax burden in Brazil is currently at 33% of the GDP, up from 28% at the time of the Real Plan; these comprise average values.

The Brazilian tax burden regarding the GDP went from 13.8% in 1946 to around 25% at the beginning of the 1980’s, remaining stable until 1990, when it was below 24%. As from 1992, it started to soar, exceeding 30% in 2000, according to data from the Brazilian Internal Revenue Service. Although this data indicated an expressive growth, it is in agreement with the international standard. Consider the

case of the United States, for example, whose same ratio was, at the end of World War II, around 25%, having reached 33% in 1996, according to IMF data. Thus, the statement that the Brazilian tax burden is exaggeratedly high does not find a basis when comparing this country with others of the same size.

When considering the argument that the State expends and collects badly, however, one sees that history of the national tax system suggests that this argument may be true. The Brazilian tax system is historically an inheritance from the past, a period in which this system was initially turned to taxes on imports. The tax system had its first significant change in the Republican period only with the 1934 Constitution, when internal taxes on products started to gain projection in relation to what they focused on import and export operations. The next major step in reformulating the tax system was made in 1960, when a reform which had as its purpose increasing the State's collection capacity and raise the economic efficiency of the system.

Following that year, several changes were made effective only in the sense of increasing the collection capacity and, whenever possible, reduce the degree of tax division among the federated entities.⁵

Some lessons can be learned from the evolution of our tax system. In the first place, the latter has always been turned to the public deficit financing, regardless of the issue of collection efficiency or of the burden of creating new taxes to "top up" collection. Secondly, collection centralization by the Federal Union in taxes not liable to sharing, led the states and municipalities also to seek for new taxes or increase the existing ones, so as to face the growing demands for public assets long envisaged in Wagner's law.

The multiplicity of taxes and the constant changes to the rules which allow the federated entities to fight for tax shares leads, in its turn, to suspicion on the part of the agent, the one on which tax is levied, that these entities are not able to check their own rules and that these change as a reflection of this impossibility. As a result, the volume of tax evasion grows as new taxes and new rules are created, and new

⁵ In fact, as pointed out by Giambiagi: "The low participation of taxation on income and on equity reflects a central government bias toward taxes easier to collect, such as those which use billings as a basis for incidence. Despite being of worse quality, these taxes feature high tax productivity, mainly in inflationary contexts. Moreover, their revenues are not shared with states and municipalities, which explains, to a great measure, the central government's preference (Giambiagi, 2000, p. 248.)".

taxes and rules are created to compensate for the loss of collection brought about by this evasion. The costs with the inspection structure tend to rise and, in case the necessary investments are not performed, the taxpayer can interpret such fact as an indication that the inspection system is not effective.

The final result is that the system is stuck in a vicious circle, in which both rates are raised and new taxes are created. The process remained the same throughout the entire 1994-2002 period and, at least in the agents' initial expectations, it would be broken with the rise of a government, with popular aspirations, to the central power in 2002.

However, not only the circle was not broken but also rate increases were approved and devices which raised the average rate of taxes in the economy were kept.

The actual variation in the federal collection grew significantly more than the GDP between 1998 and 2004, except for 2003, the year in which the economy displayed contraction and when tax collection results presented a fall vis-à-vis the GDP. However, the differences noted throughout the said period are too high to be explained only by rate increase.

This variable comprises the inspection effort, which was significantly high along the last 10 years.

This implies that a model geared to the national reality should consider that the level of tax evasion should be included as a function of some determining variable, in addition to the agents involved the State and the taxpayers. The tax evasion level shall be related to the subjective probability that the taxpayer assigns to the public machine catches him in the illicit act of tax evasion. In some models, this probability is directly given by the taxpayers' tax evasion rate.

In other models, the tax evasion rate depends on the perception that the taxpayer holds of the government's inspection structure effectiveness, which the former observes through the public expenses with this structure.

What has occurred in Brazil in the recent years has been a movement toward raising the efficiency of the inspection structure through increments in infrastructure, personnel and, even, in the change of paradigms. The focus of inspection has started to concentrate in information crossing and in the use of integrated systems. New legislation was created to integrate the financial institution databases with the

Brazilian Federal Revenue Service databases, which allows for significantly increasing system efficiency at a low cost.

Despite this difference in essence, Brazil has taken, under the inspiration of Rui Barbosa, a republican model copied from the North American model. The 1891 Constitution attempted to reproduce the North American institutions, including the Judiciary Power.

The Brazilian Constitution drafter Rui Barbosa imagined that, if there was liberty in America and taxation was, in terms, controlled by its citizens, Brazil would find a similar format.⁶

In the same line of reasoning, there also stands out the difficulty found in establishing the limits of state intervention, whether in taxation, or in the economy itself, as pointed out by Milton Friedman.⁷

The main objective of that work is analyzing the tax benefits of philanthropic entities in Brazil and in the USA, going through the differences in the systems and seeking to find a fairer and more effective Brazilian model.

In Brazil, it is common that very profitable corporations, headed by wealthy persons become philanthropic only to acquire tax benefits, a distortion which comprises the root of all problems.

The philanthropic entities perform activities inherent to the State, such as education and social assistance. The Economic Analysis of the Law understands that this substitution is economically interesting even if the State fails to collect some taxes through exemptions and immunities.

Currently, the research points that the Third Sector answers for 1.5% of the Brazilian GDP. This number, albeit relevant, is much beyond the sector representativeness in more developed countries, explicating an enormous growth potential in the economic field. In the United States of America, the same Third

⁶ Work mentioned, Giambiagi, 2000, p. 243.

⁷ Government activity based on policies is, for several reasons, the most complicated for a liberal, as it involves the acceptance of the principle that some should decide for the others [...] There is not one formula which can tell us when to stop. We have to trust our fallible judgment and, having reached it, our ability to persuade others that is the right judgment or be persuaded by them to change our visions [...] We should place our faith, thus, in the consensus reached by imperfect men, through free discussion, attempt and error. In FRIEDMAN, Milton. *Capitalism and freedom*. Chicago: University of Chicago Press, 1962, p. 33-34.

Sector represents 6.3% of the American GDP.⁸

2.2 Timeline of America's Philanthropic Sector⁹.

In 1643, the first account of a fundraising drive in America is organized by Harvard University. It raised 500 pounds.

In 1835, in *Democracy in America*, Alexis de Tocqueville highlights the philanthropic spirit of Americans as one of the country's strengths.

In 1889, *The Gospel of Wealth*, an essay by Andrew Carnegie, is published. In it he argued that the rich had an obligation to distribute their wealth in their lifetimes for the betterment of society, rather than leaving it for their families to inherit.

In 1907, The Russell Sage Foundation was established for "the improvement of social and living conditions in the United States." This is the first private family foundation.

In 1913, Congress passes the Revenue Act of 1913 exempting charities from paying federal income tax. John D. Rockefeller establishes the Rockefeller Foundation.

In 1914, Established by Frederick H. Goff, the Cleveland Foundation becomes the world's first community foundation. Goff's concept was to create a "community trust" that would combine the resources of the community's philanthropists and distributed the interest generated from their gifts for the benefit of the community.

In 1917, thanks to the Revenue Act of 1917, taxpayers can deduct their charitable contributions off their federal income taxes. 1921 Congress enacts the Revenue Act of 1921 which expands the definition of tax-exempt charitable organizations and permits estate tax deductions for charitable contributions. Estimates put charitable giving at \$1.7 billion. 1935 Corporations are now permitted to deduct charitable contributions.

⁸ According to Lester Salomon, "Investment management in the nonprofit sector: studying the performance of private foundations", in David Hammanck and Dennis Young (editors), *Nonprofit organizations in a market economy: Understanding new roles, issues, and trends*. 1st ed. San Francisco, Jossey-Bass, 1993. P. 233.

⁹ See James J. Fishman, *The Development of Nonprofit Corporation Law and an Agenda for Reform*, page 34.

In 1941, the Form 990, an informational tax return completed annually by nonprofits, was filed for the first time for tax years ending in 1941. The original 990 required nonprofits to answer several yes or no questions provide an income statement and balance sheet. It was only two pages long.

In 1953, approximately 50,000 groups have obtained charity status from the IRS. In the next year, the General Electric Company is credited as being the first corporation to offer its employees a matching gift program.

In 1962, living individuals give \$9.89 billion to charity, far surpassing donations by foundations (\$700 million), bequests (\$700 million) and corporations (\$540 million).

In 1964, although giving in the Federal workplace goes as far back as the 1940s, it wasn't until in 1961 that President John F. Kennedy authorized the creation of a formal fundraising program. Launched in 1964, the first Combined Federal Campaign raised \$12.9 million.

In 1969, the Tax Reform Act of 1969 vastly changes tax-exempt law. For the first time, a distinction is made between public charities and private foundations allowing the government to subject private foundations to a payout rate and requiring them to pay an excise tax. The act also increased the deduction limit for charitable contributions to 50% of a taxpayer's adjusted gross income and detailed limits for noncash gifts. This legislation also paved the way for advances in planned giving, including the creation of charitable remainder trusts, charitable lead trusts and pooled income funds.

In 1987, non-itemizers can no longer claim a charitable deduction on tax returns.

In 1990, approximately 40,000 organizations apply for tax-exempt status this year. The number of charities has grown to nearly half a million.

In the next year, Fidelity Investment's Charitable Gift Fund is created enabling its customers to take advantage of the benefits of donor-advised funds. These funds, which have long been available through Community Foundations and Jewish Federations, allow donors to claim an income tax deduction for the year in which the gift to the donor-advised fund is made, even though the money may not be distributed to a charity, recommended by the donor until sometime in the future.

Inspired by the yellow ribbons honoring military personnel serving in the Gulf war, the Visual AIDS Artists Caucus creates the red ribbon in 1991 as a symbol of compassion for those afflicted with AIDS. The first celebrity to wear the red ribbon publicly was Jeremy Irons at the Tony Awards.

In 1999, a new legislation requires charities to provide copies of their three most recently filed Forms 990 to anyone who makes a request in-person or in writing. The American Red Cross raises \$2.7 million online. This is the most amount of money that a charity has received in a year from online gifts.

September 11, 2001 Terrorists attacked the United States of America killing and injuring thousands. Horrified and compassionate Americans subsequently donate \$2.2 billion to various charities that had quickly set up 9/11-related funds. This is the most money ever raised in response to a single catastrophe. Under pressure from the media, politicians and donors, the majority of this money was spent within a year of the attacks.

The benefits of online giving, including convenience and timeliness, cause this form of giving to take off in the wake of the 9/11 attacks. In just two weeks following the attacks, online giving was responsible for \$60 million in gifts to the American Red Cross.

In April 15, 2002, Charity Navigator is launched to help charitable givers make intelligent giving decisions. The new, free service catalogs the financial health of over eleven hundred charities.

In May 5, 2003, The Supreme Court's ruling in *Madigan v. Telemarketing Associates*, allows states to take legal action against fundraisers that engage in deceptive practices. Now states can protect donors from aggressive fundraisers who lie about the intended use of donated funds. However, the outcome results in little real reform, as it does nothing to curtail the excessive fees telemarketers charge charities.

In December 1, 2004, to help donors avoid becoming victims of mailing-list appeals, Charity Navigator begins to assess each charity's commitment to keeping donors' personal information confidential.

In December 26, 2004, millions of Americans opened their wallets and give a total of \$1.54 billion to support relief causes in the wake of the disastrous tsunami in South Asia.

In August 29, 2005, Hurricane Katrina devastates the gulf coast and philanthropists respond by giving \$6.5 billion. The pace and level of giving was unprecedented, breaking all previous records of disaster-related giving.

In the next year, charitable organizations receive \$295 billion or 2.2 percent of GDP. As usual, the majority of that giving came from individuals (75.6%). Foundations (12.4%), bequests (7.8%) and corporations (4.3%) account for the remainder of the giving.

According to the IRS, more than 1 million public charities and private foundations exist. With little to no barriers to entry, this represents a 63% increase in the number of charitable organizations since 1996. More than 80,000 organizations apply charitable organizations each year.

Federal and postal employees and military personnel give \$271.6 million via the Combined Federal Campaign despite concerns about the fund's lack of oversight of participating charities.

In 2007, nearly twenty thousand donors accessed Charity Navigator's ratings and subsequently give more than \$2.6 million online via a partnership with Network for Good. More than 2,200 charities are on the receiving end of all this generosity.

In April 2008, with evaluations of over five thousand charities, Charity Navigator is the nation's largest and most-utilized evaluator of charities.

3. Charitable Entities Exemption in the United States of America.

3.1 Philanthropy under the Law.

The Constitution of the United States is the document on which the system of fundamental laws and principles that prescribes the nature, functions and limits of the government of the United States is recorded.

Constitutional principles are the rule of law, separation of powers, representative government, checks and balances, individual rights, freedom of religion, federalism, and civilian military control.

Philanthropy includes voluntary and active efforts to promote human welfare and well being. The origin of the word philanthropy is Greek and means love for mankind. Philanthropy is usually expressed by efforts to enhance the common good

and well being of humanity through personal acts of practical kindness or by financial support of a cause or causes. Philanthropy comprises any effort to improve quality of life or relieve human suffering.

The common good involves individual citizens working together for the greater benefit of all and to promote community welfare.

Regulation and encouragement of charity had been anticipated by the earliest state constitutions. All charitable bodies, initially informal organizations acting through churches or as the responsibility of leading citizens, were seen as public services whose value to the state was acknowledged by exemption of the property of donors from taxation. If citizens needed the service, its provision by private citizens with their own funds had values the state could afford to reward.

These values were carried forward into the new country's national Constitution. Yet the Constitution's implied emphasis on the authority of states and local communities to control education—the oldest of policy issues with which philanthropy deals—and social welfare makes the federal role a fragile one.

Core democratic values are the fundamental beliefs and constitutional principles of American society expressed in the Declaration of Independence, the United States Constitution and other significant documents, speeches and writings of the nation.

Fundamental American beliefs include the right to life, liberty, economic freedom and pursuit of happiness. The purpose of government is to protect these rights and it may not place unfair or unreasonable restraints on their exercise. In addition to basic rights, America shares belief in the common good, justice, equality, religious freedom, diversity, truth, popular sovereignty and patriotism.

The Constitution guarantees the rights and liberties of the people of the United States by making them part of the fundamental laws and principles of the United States government.¹⁰

All United States laws, executive actions and judicial decisions must conform to the Constitution.¹¹

¹⁰ Article I, Section 8 of the Constitution affords Congress power to “lay and collect taxes” [] “for the common defense and general welfare of the United States”.

¹¹ Article VI, cl.2 of the Constitution states, “This Constitution, and the laws of the United States which shall be made in pursuance thereof, and all treaties made, or which shall be made, under the authority of the United

Under federal law, philanthropic gifts made to religious and nonprofit organizations for charitable purposes are exempt from taxation.

Philanthropy has strong roots in religious beliefs, the history of mutual assistance, democratic principles of civic participation, group approaches to problem solving and American traditions of individual autonomy and limited government.

The Constitution's philanthropic ties are summarized in its preamble.¹²

Although the United States Constitution does not specifically address philanthropy, philanthropic values are rooted in the core values and beliefs of America's Founding Fathers, who participated in drafting these fundamental principles of American government.

Constitutional Amendment I, contained in The Bill of Rights, extends Constitutional protections to religious organizations¹³, many of which also operate charities on behalf of the public and public welfare, by affirming that "*Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof*".

Hardships faced by early settlers to North America, where government was weak and distant, forced people to join together to govern themselves, help each other and undertake community activities such as building schools and churches and fighting fires. Out of these experiences grew a tradition of citizen initiatives and individual efforts to promote the public welfare. Religious leaders also encouraged their members to give to the poor and to charitable works of churches.

Several personalities in American history were involved with the charity issue, such as Benjamin Franklin (1706-1799), John Marshall (1755-1835) and

States, shall be the supreme law of the land; and the judges in every state shall be bound thereby, anything in the Constitution or laws of any State to the contrary notwithstanding".

¹² "*We the people of the United States, in order to form a more perfect union, establish justice, insure domestic tranquility, provide for the common defense, promote the general welfare, and secure the blessings of liberty to ourselves and our posterity, do ordain and establish this Constitution for the United States of America*".

¹³ After the revolution, the colonialists felt the same distrust for the Church of England as that for Rome. See again, James J. Fishman, *The Development of Nonprofit Corporation Law and an Agenda for Reform*, 34 Emory L.J. 617, 624 (1985) (commenting on the ongoing anti-charity-anti-clerical atmosphere of the post-colonial period); Note, *The Enforcement of Charitable Trusts in America: A History of Evolving Social Attitudes*, 54 Va. L. Rev. 436, 443-44 (1968) (same). This distrust of the Catholic Church reached into the late nineteenth century, creating opponents of tax exemption for religious institutions. See Stephen Diamond, "Of Budgets and Benevolence: Philanthropic Tax Exemptions in Nineteenth Century America", 17 (Oct., 1991) (Address at the N.Y.U. School of Law, Program on Philanthropy, Conference on Rationales for Federal Income Tax Exemption, Oct. 1991), <http://www.law.nyu.edu/ncpl/abtframe.html> (last visited Jul. 9, 2003); see also Erika King, *Tax Exemptions and the Establishment Clause*, 49 Syracuse. L. Rev. 971, 1037 n.8 (1999)

George Washington (1732-1799).

Franklin, as its oldest member at age 81, was called the “Sage of the Constitutional Convention.” He achieved financial independence as a printer and publisher with his most successful literary venture the annual Poor Richard’s Almanac. Franklin gained recognition for his philanthropy and the stimulus he provided by donating part of his wealth to provide and support civic causes including libraries, schools, and hospitals. He also pursued interests in science and politics serving multiple municipal colonial government roles. For fifteen years, Franklin resided in England where he became a celebrated spokesman for American rights, returning to Philadelphia in 1775 to become a distinguished member of the Continental Congress.

Marshall, appointed by President John Adams as fourth Chief Justice of the Supreme Court, had a significant and lasting impact on the Court and the United States during his 34 years on the Court. He expressed the challenge in maintaining free government by noting, “*We must never forget that it is a constitution we are expounding...intended to endure for ages to come, and consequently, to be adapted to the various crises of human affairs*”.

Washington represented Virginia as the first and second Continental Congresses. He served with distinction in the militia and, in 1775, was appointed Commander in Chief of the Continental Army. Washington was unanimously chosen to preside over the Constitutional Convention and as first President of the United States of America. He provided stability and authority to the emergent nation and gave substance to the Constitution, whose success was immeasurably influenced by his presence and dignity. As President, Washington appointed the six original Justices of the Supreme Court and before the end of his second term, appointed another four Justices.

The two most famous philanthropists of the Gilded Age pioneered the sort of large-scale private philanthropy of which foundations are a modern pillar: John D. Rockefeller and Andrew Carnegie. The businessmen each accumulated private wealth at a scale previously unknown outside of royalty, and each in their later years decided to give much of it away. Carnegie gave away the bulk of his fortune in the

(quoting James Madison’s statement that “[t]here is an evil which ought to be guarded [against] in the indefinite accumulation of property from the capacity of holding it in perpetuity by ecclesiastical corporations.”)

form of one-time gifts to build libraries and museums. Rockefeller followed suit (notably building the University of Chicago), but then gave nearly half of his fortune to create the Rockefeller Foundation. By far the largest private permanent endowment for charitable giving created at that time, the Rockefeller Foundation was the first to become a widely understood example of the species: a standing charitable grant-making entity outside of direct control by any level of government.

Meanwhile in 1914, Fredrick Goff, a well-known banker at the Cleveland Trust Company, sought to eliminate the "dead hand" of organized philanthropy and so created the first community foundation in Cleveland. He created a corporately structured foundation that could utilize community gifts in a responsive and need-appropriate manner. Scrutiny and control resided in the "live hand" of the public as opposed to the "dead hand" of the founders of private foundations.

Starting at the end of World War II, the United State's high top income tax rates spurred a burst of foundations and trusts being created, of which many were simply tax shelters. President Harry S. Truman publicly raised this issue in 1950, resulting in the passage later that year of a federal law that established new rigor and definition to the practice. The law did not go very far in regulating tax-exempt foundations, however, a fact which was made obvious throughout the rest of that decade as the foundation-as-tax-refuge model continued to be propagated by financial advisors to wealthy families and individuals. Several attempts at passing a more complete type of reform during the 1960s culminated in the Tax Reform Act of 1969, which remains the controlling legislation in the United States.

Until a more defined system of tracking philanthropic organizations and donations became necessary for financial purposes, American philanthropic efforts were informal and not officially classified under early American law. Tax designations and codes now regulate exempt and non-exempt charitable giving and define organizations and foundations conducting philanthropic activity in the United States.

3.2 The Exemption of Nonprofit Organizations.

A foundation is an entity established as a nonprofit corporation or a charitable trust, with a principal purpose of making grants to unrelated organizations or institutions or to individuals for scientific, educational, cultural, religious, or other

charitable purposes. This broad definition encompasses two types of foundations. In **private foundations**, funds come from one source, whether an individual, a family, or a corporation. **Public foundations** normally receive assets from multiple sources, which may include private foundations, individuals, government agencies, and fees for service.

Whereas for-profit corporations exist to earn and distribute taxable business earnings to shareholders, the nonprofit corporation exists solely to provide programs and services that are of public benefit. Often these programs and services are not otherwise provided by local, state, or federal entities. While they are able to earn a profit, more accurately called a surplus, such earnings must be retained by the organization for its future provision of programs and services. Earnings may not benefit individuals or stakeholders. Nonprofit organizations may put substantial funds into hiring leadership and management personnel. In the past, many nonprofits considered this to be unreasonably businesslike and money-focused, but since the late 1980s there has been a growing consensus that nonprofits can achieve their missions more effectively by using some of the same methods developed in for-profit enterprises. These include effective internal management, ensuring accountability for results, and monitoring the performance of different divisions or projects in order to make the best use of their funds and people. Those require management and that, in turn, begins with the organization's mission.

To be tax-exempt under the Internal Revenue Code, an organization must be organized and operated exclusively for exempt purposes, and none of its earnings may inure to any private shareholder or individual. In addition, it may not be an action organization, i.e., it may not attempt to influence legislation as a substantial part of its activities and it may not participate in any campaign activity for or against political candidates.

Charitable organizations are restricted to how much political and legislative – lobbying - activities they may conduct.

Political activities and legislative activities, commonly referred to as lobbying, are two different things, being subject to two different sets of rules, which depend on several issues: the type of tax-exempt organization, the type of activity - political or lobbying at issue; and the scope or amount of the activity conducted, and the consequences of exceeding the given set of limitations.

Charitable organizations are prohibited from conducting political campaign activities to intervene in elections to public office.¹⁴

Such organizations are commonly referred to as *charitable organizations*, being eligible to receive tax-deductible contributions.

The organization must not be organized or operated for the benefit of private interests, and no part of a charitable organization's net earnings may inure to the benefit of any private shareholder or individual. If the organization engages in an excess benefit transaction with a person having substantial influence over the organization, an excise tax may be imposed on the person and any organization managers agreeing to the transaction.

To be organized exclusively for a charitable purpose, the organization must be a corporation, or unincorporated association, community chest, fund, or foundation. A charitable trust is a fund or foundation and will qualify. However, an individual will not qualify. The organizing documents must limit the organization's purposes to exempt purposes and must not expressly empower it to engage, other than as an insubstantial part of its activities, in activities that are not in furtherance of one or more of those purposes. This requirement may be met if the purposes stated in the organizing documents are limited to those needed for setting up a charitable organization.

In addition, an organization's assets must be permanently dedicated to an exempt purpose. This means that if an organization dissolves, its assets must be distributed for an exempt purpose, to the federal government, or to a state or local government for a public purpose. To establish that an organization's assets will be permanently dedicated to an exempt purpose, its organizing documents should contain a provision ensuring their distribution for an exempt purpose in the event of dissolution. If a specific organization is designated to receive the organization's assets upon dissolution, the organizing document must state that the named organization must be a charitable organization upon asset distribution. Although reliance may in some cases be placed upon state law to establish permanent dedication of assets for exempt purposes, an organization's application can be processed by the IRS more rapidly if its organizing documents include a provision

¹⁴ Certain activities or expenditures may not be prohibited depending on the facts and circumstances.

insuring permanent dedication of assets for exempt purposes.

An organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in the legislation. An organization will not be so regarded if more than an insubstantial part of its activities does not further an exempt purpose.

The exempt purposes are charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and preventing cruelty to children or animals. The term charitable is used in its generally accepted legal sense and includes relief of the poor, the distressed, or the underprivileged; advancement of religion; advancement of education or science; erecting or maintaining public buildings, monuments, or works; lessening the burdens of government; lessening neighborhood tensions; eliminating prejudice and discrimination; defending human and civil rights secured by law; and combating community deterioration and juvenile delinquency.

Many charitable organizations, other than testing-for-public safety organizations, are eligible to receive tax-deductible contributions.

The charity must furnish a statement in connection with either the solicitation or the receipt of a quid pro quo contribution. If the disclosure statement is furnished in connection with a particular solicitation, it is not necessary for the organization to provide another statement when the associated contribution is actually received.

A penalty is imposed on a charity that does not make the required disclosure in connection with a quid pro quo contribution of more than \$75. The penalty is \$10 per contribution, not to exceed \$5,000 per fund-raising event or mailing. The charity can avoid the penalty if it can show that the failure was due to reasonable cause.

A qualified person corrects an excess benefit transaction by undoing the excess benefit to the extent possible, and by taking any additional measures necessary to place the organization in a financial position not worse than that in which it would be if the disqualified person were dealing under the highest fiduciary standards.

A **public charity** receives a substantial part of its income, directly or indirectly, from the general public or from the government. The public support must

be fairly broad, not limited to a few individuals or families.

A **private foundation**, sometimes called a non-operating foundation, receives most of its income from investments and endowments. This income is used to make grants to other organizations, rather than being dispersed directly for charitable activities.

Some organizations automatically acquire charitable status upon filing of proper organizational documents, at least until annual income exceeds a statutory threshold. Others will not receive charitable status until they file an application and supporting documentation to the IRS and have a certification letter issued.

The Internal Revenue Code defines many kinds of non-profit organizations which do not pay income tax. However, only charitable organizations can receive tax-deductible contributions and avoid paying property and sales tax. For instance, a donor would receive a tax deduction for money given to a local soup kitchen if the organization was classified as a charitable organization, but not for giving money to the National Basketball Association, even though the NBA is a non-profit association. Neither a public charity nor a foundation can pay for or participate in partisan political activity, unless they surrender tax-exempt status including voiding the deductibility of any tax deductions for donors after the surrender or revocation date.

Private foundations typically have a single major source of funding - usually gifts from one family or corporation rather than funding from many sources - and most have as their primary activity the making of grants to other charitable organizations and to individuals, rather than the direct operation of charitable programs. When a person or a corporation founds a private foundation frequently family members of that person or agents of the corporation are members of the governing board. This limits public scrutiny over the private foundation, which entails unfavorable treatment compared to community foundations.

The Tax Reform Act of 1969 defined the fundamental social contract offered to private foundations. In exchange for exemption from paying most taxes and for limited tax benefits being offered to donors, a private foundation must (a) pay out at least 5% of the value of its endowment each year, none of which may be to the private benefit of any individual; (b) not own or operate significant for-profit businesses; (c) file detailed public annual reports and conduct annual audits in the same manner as a for-profit corporation; (d) meet a suite of additional accounting

requirements unique to nonprofits.

Administrative and operating expenses range from trivial at small unstaffed foundations, to more than half a percent of the endowment value at larger staffed ones. Congressional proposals to exclude those costs from the payout requirement typically receive much attention during boom periods when foundation endowments are earning investment returns much greater than 5% (such as the late 1990s); the idea typically fades when foundation endowments are shrinking in a down market (such as 2001-2003).

In the United States of America, non-profit organizations are formed by incorporating in the state in which they expect to do business. The act of incorporating creates a legal entity enabling the organization to be treated as a corporation under law and to enter into business dealings, form contracts, and own property as any other individual or for-profit corporation may do.

A primary difference between a nonprofit and a for-profit corporation is that a nonprofit does not issue stock or pay dividends and may not enrich its directors. However, like for-profit corporations, nonprofits may still have employees and can compensate their directors within reasonable bounds.

In many countries, nonprofits may apply for tax exempt status, so that the organization itself may be exempt from income tax and other taxes. In the United States, to be exempt from federal income taxes the organization must meet the requirements set forth by the Internal Revenue Service.

After a recognized type of legal entity has been formed at the state level, it is customary for the nonprofit organization to seek tax exempt status with respect to its income tax obligations. That is typically done by applying to the Internal Revenue Service, although statutory exemptions exist for limited types of nonprofit organizations. The IRS, after reviewing the application to ensure the organization meets the conditions to be recognized as a tax exempt organization may issue an authorization letter to the nonprofit granting it tax exempt status for income tax payment, filing, and deductibility purposes. **The exemption does not apply to other Federal taxes such as employment taxes.** Additionally, a tax-exempt organization must pay federal tax on income that is unrelated to their exempt purpose.

Failure to maintain operations in conformity to the laws may result in an organization losing its tax exempt status. However, the revocation of the

status is not a radical measure as we find in Brazil. The losing of the status can happen for one year, or for a period of time that the problem occurred. ¹⁵

Individual states and localities offer nonprofits exemptions from other taxes such as sales tax or property tax. Federal tax-exempt status does not guarantee exemption from state and local taxes. These exemptions generally have separate application processes and their requirements may differ from the IRS requirements. Furthermore, even a tax exempt organization may be required to file annual financial reports at the state and federal level.

In the twentieth century, tax-exempt foundations have grown substantially, both in their financial importance and in the scope of their activities. Several books¹⁶ have been written which examine the economic, cultural and intellectual implications of tax-exempt organizations. How do various tax laws influence foundations and what types of ideas do foundations produce? How do the activities of foundations relate to the interests and intentions of their founders? Does the economic management of foundation assets serve the public good, or would such assets be better employed through the private sector? Around the turn of the century, individuals who had amassed substantial wealth wanted to direct some of it toward activities that would further the public interest. Their individual motives may have varied. John D. Rockefeller was interested in deflecting public criticism by using his wealth to further the public interest. James B. Duke, who endowed Trinity College in North Carolina, wanted to enshrine his family name. How well do the foundations' activities match the intents of their founders? Non-profit foundations have grown because contributions to them are tax-deductible. Federal estate taxes were established in 1916, and rose to as high as 25 percent during World War I. The top

¹⁵ Illinois' highest court in 2010 ruled that state officials were justified in their decision to yank the tax exemption of Downstate Provena Covenant Medical Center for not providing enough charity care, a ruling that could have implications for thousands of hospitals nationally. In this decision, the Supreme Court upheld the denial of property tax exemption for the tax year in question, agreeing with the appellate court that the record was inadequate to demonstrate that Provena was a charitable institution. March, 18, 2010. **No. 107328**

Provena Covenant Medical Center v. Department of Revenue, Appellate Citation: 384 Ill. App. 3d 734. <http://www.state.il.us/court/opinions/supremecourt/2010/march/summaries/107328s.htm>. Accessed in 03/25/2010.

¹⁶ One of the books on the subject, *Writing Off Ideas: Taxation, Foundations, and Philanthropy in America*, examines these and related questions primarily by looking at specific examples as well as the overall impact of foundation practices economically and socially.

rate was increased to 70 percent in 1935. Beginning in 1942, the top rate was raised to 77 percent, where it remained for decades. The top rate is now 55 percent. Does the tax law create organizations shielded from economic realities and true social needs, producing a self-indulgent, philanthropic subculture that often squanders resources, and fosters questionable ideologies.

There are also problems in the US system: it is the general opinion that the public expects three things from foundation managers: that they do not use their assets for their own personal gain, that they carry out the mission established by their donors, and that their activities generally benefit members of the public. It is deemed that the current limitations imposed by Congress on foundation activities have forced their managers to comply with these expectations. Although it is not believed that all foundation activities actually serve the public interest, it is acknowledged that efforts by bureaucrats to further regulate foundations would have unintended consequences. Ultimately, accusations of political bias should not derail important contributions to the policy debate.

Overall, Randall Holcombe¹⁷ has done an excellent job of explaining why foundation trustees face strong incentives to promote radical political agendas that can be harmful to the public interest. He demonstrates an acute understanding of public choice economics when documenting the moral hazards faced by managers of foundations. Most importantly, he recognizes *“that efforts to stamp out the bad ideas produced by these managers would do more harm than good”*.¹⁸

Another problem is similar with Brazilian system. It happens when there is fraud in the system.

The Hospital Provena case goes back to 2003, when Champaign County tax officials stripped the hospital of its exemption. Officials cited the 210-bed hospital's \$831,724 spent on “charitable activities” a year earlier, saying it fell short of the medical center's \$1.1 million in property taxes. The state's Department of Revenue upheld that decision.

¹⁷ Randall Holcombe wrote in *“Writing Off Ideas: Taxation, Foundations, and Philanthropy in America”*.

¹⁸ Op. Cit.

Provena sued to have its property tax exemption restored. A Sangamon County District Court sided with the hospital in 2007, but a state appellate court overturned that decision in 2008.

The hospital, which is owned by Provena Health, a six-hospital system based in south suburban Mokena, has been paying roughly \$1 million a year in property taxes since Champaign County took away its exemption in 2002.

Illinois law now requires hospitals to provide charity care to poor people to qualify for their tax exemption, but it doesn't specify how much.

Federal law requires that hospitals meet a "community benefit" standard to qualify for tax exemption. Under the law, adopted in 1969, hospitals cite costs such as training of medical students, research and community outreach, along with free care, as justification for their tax exemption. Critics say the standard provides hospitals too much latitude.

Now, Illinois' highest court ruled that state officials were justified in their decision to yank the tax exemption of Downstate Provena Covenant Medical Center for not providing enough charity care, a ruling that could have implications for thousands of hospitals nationally.

It's the most notable case nationally in the past two decades of a hospital losing its tax-exempt status over questions of its charitable commitment,

3.3 The Optimal Treatment of Charitable Donations.

There is an interesting economic analysis about the optimal¹⁹ treatment of tax expenditures. Empirical analysis have been done about an optimal tax model where individuals derive utility from spending on a "contribution" good such as charitable giving.

The contribution good has also a public good effect on all individuals in the economy. The government imposes linear taxes on earnings and on the contribution good so as to maximize welfare. The government may also finance directly the contribution good out of tax revenue. Optimal tax and subsidy rates on earnings and

¹⁹ I have used many concepts of economics to deal with this kind of analysis. For a deeper study of this issues, read Browning and Zupan, *Microeconomics Theory and Applications*.

the contribution good are expressed in terms of empirically estimable parameters and the redistributive tastes of the government. The optimal subsidy on the contribution good is increasing in the size of the price elasticity²⁰ of contributions, the size of the crowding out effect of public contributions on private contributions, and the size of the public good effect of the contribution good. Numerical simulations show that the optimal subsidy on contributions is fairly sensitive to the size of these parameters but that, in most cases, it should be lower than the earnings tax rate.

The US government encourages a number of economic activities or consumption patterns through tax incentives. Individuals are allowed to deduct expenses such as charitable contributions or mortgage interest payments from their taxable income. In 1995, itemized deductions reported on excess of the standard deduction represented around 12% of taxable income and cost the federal government over \$80 billion in tax revenues is around 15% of total individual federal income taxes collected in that year. Charitable giving represents about 15% of itemized deductions, and mortgage interest payments about 35%. Unsurprisingly, the use of these tax expenditures has been the subject of substantial controversy and the focus of debate among tax policy analysts.

Supporters of tax expenditures point out that it is efficient to encourage certain kinds of economic behaviors instead of using direct expenditures to achieve similar objectives. They argue that tax expenditures such as charitable giving or home ownership have positive external effects and are very responsive to tax incentives. Therefore, the government should promote these types of activities by providing a tax break.

Opponents emphasize that the external effect of such tax expenditures is too small to justify a complete tax exemption. Moreover, as tax expenditures are likely to be much more responsive to taxation than labor supply, they point out that allowing tax expenditures may both reduce the size of the tax base and increase significantly the elasticity of taxable income, thus increasing significantly the total deadweight burden from the income tax.

²⁰ Elasticity is a concept imported from economics to show how such thing changes in consequence of a change in another thing. For example, Price elasticity of demand (PED) is an elasticity used to show the responsiveness of the quantity demanded of a good or service to a change in its price. More precisely, it gives the percentage change in demand one might expect after a one percent change in price.

The economic literature has devoted considerable attention to the empirical analysis of the behavioral responses to tax incentives. Many studies have analyzed the effect of tax subsidies on home ownership and charitable giving. The distribution effect of these tax expenditures, though less systematically investigated, has also attracted some attention.

There are models which should allow determining quantitatively how the different considerations intervene and should provide optimal tax or subsidy formulas expressed in terms of magnitudes empirically estimable. No study has provided precise policy recommendations using estimates from the empirical literature and few studies have investigated the normative side of the tax treatment of charitable contributions. Some studies have examined some of the aspects of this problem but without solving an explicit social welfare maximization problem. Fewer studies have developed and analyzed the full optimal tax problem.

The size of the subsidy is closely related to the size of the external effect. If the government can also finance directly the public good with tax revenue, then it can choose the total level of public good so as to equate the external effect to the marginal value of public funds. When the contribution good is socially overprovided by the private sector, the government cannot undo this overprovision.²¹ Secondly, the optimal subsidy is positively related to the price elasticity of the contribution good. Inelastic contribution goods should be heavily taxed even if they generate a large external effect. Third, when the government can freely contribute to the public good, the more private contributions are crowded out by public contributions, the higher should be the subsidy on voluntary contributions.

There is no theoretical reason to link the subsidy rate on the contribution good to the income tax rate as is currently done in the US income tax code. The optimal tax rate on earnings is fairly independent from the price elasticity of the contribution good and can be high if earnings are not very responsive to taxation and redistributive tastes are strong. However, tying the subsidy rate to the income tax rate, as is done in the US income tax system, may increase substantially the elasticity of taxable income and reduce substantially the redistributive power of the income tax.

²¹ For a number of goods, such as religious services, the government is constrained by law not to contribute.

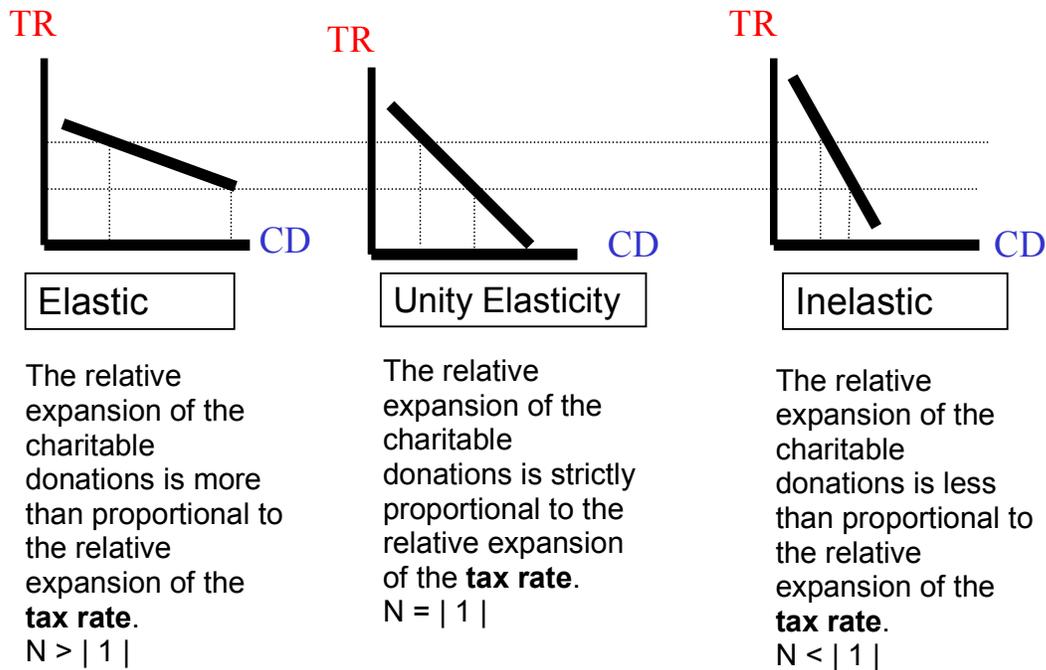
The government can supply the contribution good and this government supply in turn can crowd-out private contributions.

Empirical studies suggest that, even though the elasticity of income net of contributions is higher than the elasticity of broad income, it is not necessarily the case that the former should be taxed less than the latter.

There is still substantial uncertainty on many of the parameters entering tax formulas. Though the supply side parameters have been extensively studied in the empirical literature, the size of these central parameters is still controversial. It is also critical to assess the value of private contributions relative to direct government contributions.

Thus, in short, by utilizing a tax preference, we allocate the costs of the services charities perform among individuals in proportion to the value each person places on each charity's programs. The economic reason why we might subsidize through tax preference instead of directly is based on the tax efficiency argument: If the elasticity of charitable donations with respect the tax rate is greater than unity, then, charitable giving increases by, at least, as much as tax revenue declines.

Price Elasticity's Graphical View of Charitable Giving



CD is the charitable donations.

TR is the tax rate.

3.4 The New Challenge.

In consequence of the current financial crisis, many philanthropic entities have faced a new challenge to deal with.

Faced with steep declines in tax revenue, an increasing number of states and localities are considering eliminating various tax exemptions for nonprofit groups.

A bill before the Hawaii Legislature, for instance, would require charities to pay a 1 percent tax, and Kansas is considering making them subject to sales taxes.

Revoking the nonprofit organizations' exemptions from property taxes is also under scrutiny in several counties in Kansas, as well as in Pennsylvania.

And last fall, Minneapolis made charities subject to the fees it charges businesses and residents for streetlights in hope of gaining an additional \$155,000. Experts have described this policy as "looking under the sofa cushions."

In most cases, churches would be exempt from the tax measures, but all other nonprofit groups, including private schools and colleges, would be affected.

Nonprofit groups say the moves to wring revenue out of them are shortsighted and will produce cutbacks in critical services that governments rely on them to provide, like mental health and emergency foster care services. The problem increases because when states revenues are down, they demand for the services they provide, services that government expects them to provide, is way up.

State and local governments have tried rolling back various nonprofit tax exemptions in the past, with limited success. Some localities have negotiated “payments in lieu of taxes” from some nonprofit groups. Harvard, for example, paid the City of Cambridge \$2.2 million in 2008, as well as \$5.2 million for water and sewer service, though such arrangements are typically temporary and subject to negotiation.

But exemptions from property, sales and other taxes have largely remained sacrosanct — until now.

Many charity leaders contend that charities are already helping government defray costs because so many states and localities are long past due on payments owed to nonprofit groups for services that governments used to provide.

Hawaii is considering suspending a wide range of exemptions from the general excise tax, including the one held by nonprofit organizations. Additionally, the Honolulu City Council is talking about increasing the property tax on the groups, which is currently capped at \$100 a year.

Indiana authorities justify that a proposal to cap the amount of property taxes paid by Indiana residents is on the ballot in November, and if it passes, local government revenues across the state will fall by hundreds of millions of dollars. Indiana’s localities are considering user fees for things like police and fire services that would affect large, wealthy nonprofit organizations like universities and hospitals the most. The problem is huge because in the majority of Indiana’s localities, at least half of the property is tax-exempt because it is owned by a charity.

The increasing amount of property owned by the University of Pittsburgh’s medical center and other nonprofit groups in Pittsburgh and elsewhere prompted State Senator Wayne D. Fontana to propose legislation that would impose an “essential services” fee on charities, based on the amount of property they own. They have a lot of nonprofits continually buying up real estate and expanding and getting bigger and

bigger. Each piece of property that are bought by charitable entities becomes untaxable, which means everyone else has to pay more in property taxes just to maintain service levels.

Once more, the North American culture that community is more important than a person or a sector of the economy starts to re-think an antique tradition of exemption, in consequence of the hard moment that the entire population faces.

4. Tax Immunity of Brazilian Charitable and Social Assistance Entities.

4.1 The Importance of the Third Sector.

In the social field, the market changes as well as the transformation of the Brazilian society ascertained in the last thirty years have led to a redistribution of the roles of each social player towards reaching the common good in which, progressively, the organized civil society took on new responsibilities for the protection and defense of rights, previously inserted in the exclusive orbit of the State, the First Sector, as, until that moment, the private initiative, that is, the second sector, understood that its social role was limited to the payment of taxes and generation of jobs. The growth in the number of civil society organizations, as from the 1970's led to the rising of a new social player, the so-called Third Sector, the body of private agents with political purposes, whose programs aimed to fulfill basic social rights and fight social exclusion and, more recently, protect the Brazilian ecological wealth.

The Third Sector institutions fulfill the primary role of the State which, on account of financial or managerial inability, is not able to provide the entire population with services in educational and social assistance areas. Thus, tax immunity and exemption to such private entities, which take up the role of the State, do not comprise on benefit, but rather, the non-taxing of state activities, that is, the State taxing the State, having as its evident purpose allowing for the said activities and, as a consequence, making available to the population services which the States does not provide.

There is an important differentiation to make between association, institute, civil society and foundation. An association can be defined as a corporate person created as from the ideas and efforts of persons around a purpose which does not bear a for-profit purpose. The institute does not correspond to a kind of legal entity, and can be used by a governmental or private entity, for-profit or not-for-profit. Conversely, a civil society is the one which aims at an economic or for-profit aim, which should be shared between the partners, being reached by the exercising of certain tasks, or by the providing of technical services. On the other hand, a foundation is defined as an asset made to serve, with no profit purpose, a determined public interest cause, which acquires a legal personality by initiative of its grantor.²²

Another kind of entity is the Social Public Service Organization (OSCIP). In June 1997, the Solidary Community Council started the political interlocution process with the participation of several representatives from the organizations of the civil society and of the government for the reformulation of the Third Sector Legal Milestone. The theme was placed in the government agenda because one of the Solidary Community priorities is promoting dialog and the performing of partnerships between the State and the civil society organizations for facing poverty and exclusion by means of innovative social development initiatives. In this context, special emphasis is given to the strengthening of civil society which has required that the incompatibility of the legislation be faced, which ruled the sector with the action and the new roles that the organizations had been taking on, as well as the regulation be adapted to the requirements of publicizing and social control demanded by society and to the requirements of flexibility in the relations with the State.

The Brazilian Constitution is quite favorable to the creation of not-for-profit organizations, allowing for the form of association or foundation, independently of authorization. However, laws were created, as from the 1930's to regulate subventions, exemptions and concession of titles and registration which began overlapping and rendering the sector legislation quite complex.

Whoever holds the two qualifications – a Federal Public Utility Statement and the Philanthropic Purposes Certificate – has access to the deduction of legal entity

²² I do not think this is the realm for discussion of public or private foundation. In this sense, read Juruena, Marcos.

donations in Income Tax, exemption of employers' contribution to social security and to the possibility of setting up agreements with state bodies and of receiving subventions. However, most Third Sector entities are not able to surpass the requirements linked to registrations and titles in several governmental instances, to have access to the existing benefits.

4.2 The Brazilian Legal Problem between Tax Immunity and Exemption.

There are all types of discussions in Brazilian doctrine on what can be defined as a charitable, philanthropic or social assistance entity.

The first discussion is established on the concept of philanthropy itself.

The norms have not defined what an education and social assistance entity is; they have only assured it tax immunity on its incomes, assets and services and as long as these are related to the essential activities of the entity, with the legal requirements having been met.

A permanently-asked issue at Courts has been the discussion on the charitable social assistance entities and the right to enjoy the constitutional tax and social contribution immunity.

It is important to highlight that the immunity institute applied to public interest entities has been contemplated since the 1946 Constitution (art. 31, V, "b" – philanthropic entities), having been improved by the 1967 Constitution (art. 19, III, "c") and definitely enshrined by the 1988 Constitution (CRFB 88). With effect, the tax immunity institute granted to public interest entities has comprised part of our legal framework for almost eight decades. Thus, the legal instability regarding the applicability of the immunity to assistential and educational entities has lasted for years.

The National Social Assistance Council has repeatedly denied the so-called "Certificates of Philanthropy", which it had always granted to the not-for-profit educational and social assistance entities, a fact which, certainly, hinders the complementary job that the private sector carries out on behalf of social activity.

The issue lies in interpreting the constitutional text, which deals with **beneficent** (gender) (art. 150, item VI, letter "c" and 195 § 7), and not **philanthropic** entities for enjoyment of immunity.

It deems that a "beneficent" entity is the one which acts on behalf of a party other than its own settlers or directors, and may be remunerated for its services. A "philanthropic" entity is an entity with an identical scope, but whose action is entirely gratuitous, that is, it charges nothing for the services it renders. The constitution drafters, by granting tax immunity did not talk about philanthropic, but rather about "social assistance and education" beneficent entities; they dealt of beneficent entities, and not only the philanthropic entities.

The essential condition for an entity to be beneficent is, in the understanding of this part of the doctrine, to comply with the dispositions of article 14, CTN, which, in its original draft only required the application of resources in the country, the non-distribution of benefits to its directors and the regular accountancy procedures. The changes to the 104/2001 complementary law did not reach, however, the profile core, nor were able to do so, there continuing to be the distinction between philanthropic and beneficent entities.

The doctrine preaches that constitutional immunity is an absolute void to the power of taxation, aimed at benefitting the private entities, which are not obliged to do what would be a government's obligation but which do so encouraged by the constitutional lifting of tax burden, as the government provides poor services to the community in these vital areas.

Such interpretations remain isolated and gives raise another series of issues.

The less radical doctrine establishes a discussion on immunity and exemption envisaged in the Brazilian Constitution.

The CRFB 88 contemplates, under art. 150, VI, c, that educational or social assistance institutions, all conditions set forth in the CTN having been complied with, may enjoy tax immunity relative to their equity, income and services. However, it also envisages, in its art. 195, § 7:

*"§ 7 The social assistance beneficent entities which meet the requirements set forth under **the law** are **exempt** from social security contribution".*

This language technical flaw has generated doubts, both in the doctrine, and in the jurisprudence.

For the tax agents, the constitutional precept would be covering an exemption, for Law nº 8,212/91, in its article 55 sets forth the requirements for enjoyment of exemption of these beneficent entities regarding the social contribution.

One part of the doctrine understands that this grammatical interpretation should be put away. It understands that the Constitutional text should be interpreted in conformity with the ensemble of constitutional norms, providing emphasis to the express and implicit principles.

Actually, in spite of the Constitution denominating the institute thus, this would comprise a conditioned immunity, a constitutional limitation to the power to tax. Thus, it would be enough to fulfill the three requirements envisaged under article 14, CTN, so that the entity could enjoy the immunity and exemption.

They comprise philanthropic entities which integrate the so-called third-sector that is those which lie between the public power and the private sector, seconding the State's role in the assistential field. In spite of the terminology distinction, these beneficent entities would be the same social assistance institutions referred to under art. 150, VI, c, CRFB 88, tax-immunity beneficiaries, for performing activities listed between the State's purposes and obligations. This would comprise, no doubt, a case of immunity. It also understands that beneficent is the genre in which philanthropic is the species.

However, the STF has not yet reached a final decision regarding the nature of the law referred to under the final part of § 7, art. 195, CRFB 88.²³ As a cautionary measure, the STF understood that only art. 14, CTN, which establishes the requirements for tax immunity enjoyment would be applicable. In the merit, however, there is not yet a consensus in the sense that § 7 refers to the ordinary law, for when dealing with a complementary law, the text is always expressed in this sense.

Against this line of argumentation, these posits the tenor of art. 146, II, Federal Constitution, which says that it is up to the complementary law:

“...II- regulate the Constitutional limitations to the power of taxing”.

In this sense, in case the regulation of constitutional limitations is already

under reserve by the complementary law, § 7, art. 195, CRFB 88 would not need to be redundant.

However, it is not a settled point in the doctrine the concept of immunity as limitation to the power of taxing.

Tax expert Yoshiaki Ichihara, in his book “Tax Immunities” summarizes the doctrinaire positions of several authors²⁴, and finally defines: *“tax immunities are Federal Constitution norms, expressed and determined, which negatively limit, describing contours to attributive norms and within the field of tax jurisdiction, establishing and creating an areas of incompetence, driven to destinatority artificial persons of public right, with full efficacy and immediate applicability, implicitly granting subjective rights to the beneficiary grantees, not being mistaken for the fundamental norms, prohibitions or express voidances, with the limitations which stem from the constitutional principles, nor with non-incidence”*.²⁵

²³ Adins N° s. 1902 and 2028.

²⁴ To Souto Borges Maior, *“immunity a special hypothesis of constitutionally qualified non-incidence”*

Hugo de Brito Machado posits that *“immunity is the obstacle stemming from the Constitutional to the incidence of the legal tax rule”*.

José Eduardo Soares de Melo states that *“immunity consists of the exclusion of the Union, States, Federal District jurisdiction to institute tax pertaining to certain acts, facts and persons, expressly envisaged in the Federal Constitution”*.

Ives Gandra da Silva Martins, in his turn, argues the thesis that the *“immunities, in Brazilian law externalize the absolute prohibition to the power to tax within the limits set forth by the Constitution”*.

To Luciano da Silva Amaro *“the tax immunities, on a per of a complex of boundaries based on the Constitution, limit the jurisdiction, that is to say, set forth the boundaries of the field in which the power to tax is exercisable... They are, therefore, defining instruments (or limits) of tax jurisdiction of the public entities”*.

To Sacha Calmon Navarro Coelho *“immunity comprises a heterolimitation to the power to tax. The will to prohibit pertains to the constitution drafter. Immunity resides exclusively in the Constitutional building”*.

Misabel Abreu Machado Herzi proclaims that *“immunity is an express constitutional rule (or implicitly necessary), which establishes the non-competence of the Federation’s political persons to tax certain facts and conditions, in a widely determined manner, negatively defining, by means of partial reduction, the norm of taxation power attribution”*.

Ricardo Lobo Torres defines immunity as *“a limitation of the power to tax founded on absolute liberty, having as origin the moral rights and or source the Constitution, written or not; it bears declaratory efficacy, it is irrevocable and thus comprises the main obligation as well as the accessory”*.

To Roque Antonio Carraza *“tax immunity is a constitutional nature phenomenon. The norms which, directly or indirectly deal with the subject, fix, that is to say, the incompetence of the taxing entitie to burden, with exceptions, certain persons, whether on account of their legal nature, or because they are colligated to certain facts, assets, or conditions”*.

Paulo de Barros Carvalho, in turn, defines immunity as *“the finite class, immediately determinable of the legal norms found in the Federal Constitution text and which establish, in an express manner, the incompetence of political internal constitutional law to issue rules instituting taxes which reach specific, sufficiently feature situations”*

²⁵ Ichihara, Yoschiaki, *Imunidades Tributárias*. São Paulo: Atlas, 2000.

It is ascertained that there is no doctrinary discrepancy in the sense that immunity lies exclusively on the Federal Constitution. There prevails Aliomar Baleeiro's lesson that immunity is "the constitutional discipline of competence".²⁶

This part of the doctrine understands that any tax unburdening envisaged in the constitution -- exemption or non-incidence -- should be understood as immunity, provided with constitutional supremacy feature. Immunity acts in the field of tax competence definition, whereas legally-qualified exemption and non-incidence act in the field of the tax competence exercise.

Regarding the interpretation of § 7 of art 195, together with art 146, ii of the federal constitution, it is mandatory to examine that immunity would not be a limitation to the power to tax, but, rather, a constitutional norm which does not fit cogitation of limitation of the power to tax, as there would not be a previous definition of tax competence. It argues that the immunizing norms act concomitantly with the competence norms, in a logical, not temporal relationship.

The divergence seems to be of a terminological nature. There is not reason to reject the classic definition given by Aliomar Baleeiro, in the sense that immunities are "*limitations to the power to tax.*"²⁷

One cannot state that there is no prior definition of competence. If it is true that the Federal Constitution, as a whole, is approved in a single moment, it is no less true that its texts are subject to review, discussion and approval on distinctive moments. In the first place, the competence of the Federated entities is defined. Thus, the definition of incompetence is dispensed with, as the definition of competence contains the positive and the negative aspect. This part of the doctrine understands that the aspects, the incomes and services of any person would be reached by taxation by virtue of the principles of universality and of the generality of taxation. The constitution drafter has placed, it safe from tax, certain assets, incomes, or services, at times, in relation to certain persons, thereby creating objective and subjective immunities.

In the same manner that it has granted impositive competence which configures a limitation to the power to tax, it has also voided the exercise of this competence vis-à-vis certain assets, incomes, services or persons declared immune.

²⁶ Aliomar Baleeiro, *Limitações constitucionais ao poder de tributar*: Rio de Janeiro: Forense, 1977.

²⁷ Op. Cit.

Thus, the part of the doctrine which defends the thesis of the constitutional norm which defines tax incompetence of political entities, supports that immunities are norms which negatively outline the field of competence, which presumes the previous existence of the same.

However, limiting is restricting something which already exists. Nevertheless, stating that immunity is a norm of tax incompetence addressed to the legislator, contrary to the exemption or non-incidence, addressed to the taxpayer, making it impossible to the infraconstitutional legislator the exercising of the competence, is akin to stating that *“immunities externalize absolute voidance to the power of taxing in the limits set by the Constitution.”*²⁸

Stating that the Constitution has defined the tax incompetence area is the same as saying that the Constitution has limited the power of taxation of the political entities vis-à-vis certain assets, incomes or services declared immune.

Finally, it is understood that the constitution drafter did not simply choose these assets, incomes, or services, but granted them immunity on account of relevant political and social scopes, considering, still, the fundamental rights such as freedom of worship, the liberty of thought, among others. Thus, the immunity generates material subjective rights to the beneficiaries, not susceptible to suppression by Constitutional Amendments.²⁹

This part of the doctrine proposes that, in the review of the immunities of the beneficent entities and of social assistance, the teleological interpretation be used, contrary to the other thesis, which understands that immunity results from the Constitution drafter’s political option and which can thus be revoked at any time.

Finalizing this view, the social assistance beneficent entities referred under § 7, art. 195, of the Federal Constitution would in fact be immune not applying ordinary law regulatory devices, which features them as exempt, but only the requirements established under art. 14 of the CTN.

The Brazilian federal tax administration, together with a part of the doctrine understands that the constitutional precept envisaged under § 7, art. 195, CRFB 88, would be entailing an exemption, as Law # 8,212/91, under art. 55, outlines the

²⁸ Teaches Ives Gandra da Silva Martins.

²⁹ Adin nº 939 – DF, Rel. Min. Sydney Sanches, RTJ – 151/755.

requirements for the enjoyment of exemption of these beneficent entities which are, in a tight summary:

I - that it be acknowledged as of federal and state, or of the Federal District or municipal public utility;

II - be holder of the Certificate and of the Registration of Entity with Philanthropic Purposes, supplied by the National Social Assistance Council, renewed every three years;

III - promote, gratuitously and under an exclusive character, beneficent social assistance to needy persons, especially to children, teenagers, senior citizens and physically-impaired persons;

IV - their directors, board members, partners, grantors or benefactors do not receive remuneration and do not enjoy advantages or benefits under any title;

V - fully invest in the country the possible operating result in the keeping and developing of its institutional objectives, by submitting on a yearly basis, a detailed report of their activities to the pertinent INSS body;

VI - hold a Declaratory Act of Exemption issued by the Federal Revenue Secretariat of Brazil.

However, in the study of the Work Tax Financial Constitutional Law Treatise, in the section Human Rights and taxation: Immunities and Exemptions, by Prof. Ricardo Lobo Torres, tax immunities are defined under the aegis that, in the same manner that liberty is indefinable, so are the rights to liberty and to immunity emanating from them, including tax immunities impossible to define.

From the 13th Century to the 19th Century, in which we had the Equity State, the concept which seemed closer to immunity was the limitation to the royal power to tax the nobility and the Church. Later, we had the Fiscal State, in which there was limitation to the power of the State to tax the individual's pre-existing rights.

In this sense, we reach one more concept of Immunity: it is the legal relationship which instrumentalizes fundamental rights, or the quality of the person underlying the subjective public right to non-incidence of tax or to an externalization of rights to liberty which brings forth the public entity's tax incompetence.

However, in Brazil, the positivistic approach which rejects the legitimacy of immunity by fundamental rights.

Along this positivistic line and with the grammatical interpretation of the CRFB/88 and of correlated standards, in addition to the requirements needed for exemption envisaged under art. 55, Law 8212/91, the Brazilian Federal Revenue Service is even stricter by widening the list of compulsory conditions, envisaged under art. 12, Law 9,532, dated 12/10/97, for the educational or social assistance institutions to be able to enjoy immunity related to their assets, income, and services, as assured by art. 150, item VI, paragraph "c", of the Constitution, including therein the non-incidence of Income Tax to Artificial Persons.

The said immunity would not apply to contributions to PIS/PASEP and, for those aimed at the financing of social security – COFINS, as paragraph 7th, article 195 of the Federal Constitution establishes that the social assistance beneficent entities which comply with the requirements set forth by the law are exempt, instead of immune, from social security contributions.

This interpretation leads to the fact that all Educational and Social Assistance Institutions which have their exemptions cancelled or which do not possess the certificates and the registrations for philanthropic purpose entities, as supplied by the National Social Assistance Council, have, besides the Employers' Contribution to Social Security, their respective contributions to COFINS and to PIS required by the Law, remark being made that, in this case, the calculation base would be determined according to the cumulative regime, as immune entities are prevented from opting for the non-cumulative tax regimen.

Regarding the Social Contribution on Profits, which is also part of the contributions dedicated to financing social security, as defined through letter "d", of the sole paragraph of art. 11, and item II, art. 23 of Law 8,212/91, the Brazilian Federal Revenue Service understands that the immunity of suspension shall precede such requirement, as the calculation basis for this contribution is Profit, the inexistence of which is a condition for the enjoyment of such immunity.

It is extremely common that, during fiscal action, one ascertains the existence of judicial actions brought forth aiming at the nullity of exemption as, pointed out previously, the subject is not without controversy in doctrine and in jurisprudence. The Brazilian Federal Revenue Service orientation is to perform a Tax Assessment with suspensive action, conditioned to the res judicata of the action at issue. Such procedure would have as objective the comprisal of a tax credit prior to

the end of the expiration period.

5. The Law Interpretation of Rules Relating to Brazilian Philanthropy.

In the Brazilian case, CRFB 88 bears a clear social bias, when adopting the broad social assistance concept, by imposing upon the State the duty to ensure to all the rights to health, to education, and to “social assistance”, comprising: protection to the family, to maternity, to childhood, to adolescence, to old age; the protection to needy children and teenagers, the promotion of integration to the job market; the qualification and rehabilitation of persons bearing physical impairments, and the promotion of their integration to community life - all this independently from contribution to social security. Additionally to these basic rights, the Constitution also imposes upon the State the duty to assure the rights to the protection, conservation and incentive to culture, to scientific, artistic, and technological creations, to scientific development, to research and technological qualification, as well as the incentive to formal and non-formal sports practices, and to leisure, as forms for social promotion, production and diffusion of cultural assets.

To such purpose, the Constitution has immunized, from taxes and social contributions, the assets, income, and services, related to the essential purposes of the social assistance beneficent entities, educational and social assistance institutions which, without profit purposes, subsidiarily exercise those social activities originally committed to the State, and whose notorious public interest, by itself, justifies and legitimates tax immunity granted to that sector.

However, this constitutional intent of inserting the “third sector”, in complementing the exercising of social functions due by the State, has been frustrated either by the excess of governmental regulation and accumulation of jurisdiction of government bodies involved, which postergate and hinder the enjoyment of constitutional immunity, unjustifiably burdening the complementary services made available by the private initiative, be it still by a state-oriented and bureaucratic mentality which, in addition to not fulfilling its constitutional duties of dignifyingly ensuring to the citizens the unalienable rights to health, to education, and to “social assistance”, prevents private initiative to complement the unmet state

functions, thereby victimizing the society which, at the end of the process remains as the most prejudiced entity.

It remains clear that, by assuring the tax immunity of educational and social assistance institutions without for profit purposes, the Constitutional legislator did not manifest a conditional will but an affirmative and univocal wish, in the sense of presenting and avoiding legislative and administrative arbitrariness, by equipping society with quite-effective instruments for the defense of their rights as declared in the Constitution.

Exemption in the North-American philanthropic entities cannot be mistaken with immunity, as it is not literally expressed in the Constitutional text. The North-American legislative precision also results in greater legal security for such institutions.

The factual reality to which we are subject in Brazil is that the taxation of beneficent, social assistance or philanthropic entities does not work, either by inefficiency of the system itself, or by the legal requirements for securing immunity or exemption on account of the different interpretations, given the correlated norms.

The distinction of the tax treatment given to the philanthropic entities, and those of non-philanthropic nature, that is, of merely associative nature, is clear and has been finding support in the understanding of the Brazilian Federal Revenue Service.

However, the social security legislation, followed by the Brazilian Federal Service provides the following treatment to the theme: exemption shall refer to the contributions on the payroll, SAT, COFINS and PIS/PASEP, as long as the philanthropic entity meet all requirements described under Law 8212/91.

It also requires that the Brazilian Federal Revenue Service bear a restrictive interpretation of correlated norms, this because article 111, CTN, envisages the impossibility of extensively interpreting the tax legislation which grants tax benefit.

Both government and charitable institutions are at fault, to wit: the government, by its excess of regulations and jurisdiction of governmental bodies, on account of a bureaucratic and state centered mentality; for example, any mistake is penalized by exemption revocation, retroactive five years.

Requirements must be met with no exception, lest or financial penalty be

applied, for example.

The most appropriate understanding is that beneficent social assistance entities, which meet the requirements set forth by the law, which can only be a complementary law, such as the CTN, are immune from taxation through contribution to social security.

The language technical imperfection of CRFB 88 regarding exemption and immunity contributes toward the appearing of problems of all sorts, thereby generating doubts and controversies, both in doctrine and in jurisprudence.

The beneficent, educational or social assistance institutions have acquired a differentiated treatment by the Brazilian federal tax authorities, as from the moment in which the requirements envisaged in law for the enjoyment of their tax benefits were perceived not to be fulfilled and, even so, the inspections and assessments could not reverse this picture. There appeared then the term “philanthropic” (from “pilantra” which in Portuguese means “a crook”) to define such entities.

One of the main consensus in any interlocution process to deal with the theme is establishing the need to provide, ever more, credibility to philanthropic entities by means of qualification, in the Third Sector universe, of the subset of those which act according to the principles of the public realm in the production of common good. This implies in using visibility, transparency and public control mechanism, legally established, allowing, moreover, better definition to access to possible benefits, or government incentives and private donation.

Requirements such as: not remunerating the partners, directors, board members, granters, or benefactors, and not allowing that these enjoy advantages or benefits at any title; fully apply the possible result on the maintenance and development of their institutional objectives, almost as a rule, have never been fulfilled or if they have apparently been fulfilled, law availed themselves of tax avoidance, a legal but debatable device when dealing with philanthropy-linked entities.

This is not the appropriate field for discussion if the legal requirements extrapolate reasonability, but it is imperative to keep the discussion in strictly legal term.

As from this outlook, the norms related to such entities started to be interpreted in a grammatical, literal manner, without any space for the search of its

teleological sense.

The teleological interpretation of the norms is defended by the entities and as part of modern doctrine, so that an alternative route for system survival.

For the Brazilian reality and in the strictly legal sphere of the theme, one concludes that:

a) It is imperative that STF define whether art. 195, § 7 of CRFB 88 deals with exemption or immunity, as well as the nature of the law referred to in the final part of § 7, art. 195, CRFB 88 so that, at least, the beginning of the legal and factual knot be untied. It is evident that the signaling manifested under ADIN 2028, which had its cautionary deferred for 10 votes to zero, was followed in the later decision by STF minister Carlos Brito, which leads to contemplating for the near future a decision by the STF, that the vehicle should regulate immunities; it is the complementary law, with the CTN requirements being valid throughout the national territory as, incidentally, had already been decided by the defunct Federal Appeals Court, in the 1987 leading case³⁰, in the line of the overwhelming majority of Brazilian doctrine makers.

b) The tax immunity of taxes and contributions, envisaged under arts. 150, IV "c" and 195, § 7, CRFB 88, is granted "*intuitu personae*" the "educational and social assistance institutions without profit purposes" and, for consubstantiating an exception to the principles of generality, equality, uniformity and universality of taxation, is only justified under the basic public interest existing in the activities and services developed by them and provided to the community at not interest, in the pertinent social areas of action which, for corresponding to the compliance with the social rights ensured by the Constitution, the State has the duty to provide and to stimulate and, of it came to provide with the breadth and efficiency of the private sector, or to subvention in the same measure, as it should, would certainly incur in financial costs much higher than the value of taxation. This substitution of players is fully accepted under the optics of the Economic Analysis of the Law.

c) When the CRFB 88 uses the expression "institution without profit purposes", it links the enjoyment of tax exoneration only to the entity's corporate

³⁰ Ac. 101.394-PR, Reporting Justice Ilmar Galvão, D.J. 10/31/88.

purpose, that is, the activities and services developed in the most diverse social areas of health and education. It also links to its institutional purpose and, therefore, to the application, management and final destination of the financial resources acquired by the institution in the performing of its institutional activities. There is no other restriction as to the form of legal entity they adopt. They can be an association, civil society, private or public foundation, religious organization, non-governmental organization-NGO's, or Civil Public Interest Society Organization – OSCIP. It also links to the character attributed to it, that is, beneficent, philanthropic, recreational, cultural, scientific or religious, in addition to the production of the financial resources obtained by it or to the gratuity in the services it renders. Finally, that they justify the destination and application of private property and its instrumentalities to the institutional finalities for which they were created.

d) Regarding the term “educational institution”, it is used in the CRFB 88 in a broad sense, that is, it is not restricted to the educational institutions properly said, with the vulgar usage of the term, or to those dedicated to individual capacity development, but rather, encompasses all institutions dedicated to the formation and to the development of physical, moral, intellectual, religious, artistic and cultural capacities of the individual, which, by supplying the individual deficiencies in the various areas qualify it for a full-fledged life in society.

e) The substantial nucleus of action which limits and justifies the tax immunity assured to educational and social assistance institutions without profit purposes, as it is explicated in the constitution, cannot obviously be affected by an unconstitutional legislation, for immunity is a legal rule, with a constitutional seat, limiting the competence of the federation's political entities or, rule of incompetence, which blocks the exercising of legislative activity by the state entity, as it denies competence to create imposition regarding certain special and determined facts and, therefore, does not identify itself, and distinguish itself from exemption.

f) The Federal Constitution has expressly reserved to complementary Law the competence to regulate the constitutional limitations to the power of taxing, whose implicit objective was exactly to protect some matters, in their specific from imprudent alterations on the part of ordinary legislators from the federated entities so

that the legislative competence of the federated entities to be able to operate, in plenitude, with all its consequences. It not only consubstantiates the instrument of normative limitation for compulsory compliance in the State actions, but also is meant to bestow effective protection and provide full shelter to subjects liable to tax obligation.

g) The legal requirements obviously established for the enjoyment of tax immunity and social contributions ensured to educational and social assistance institutions without profit purposes are those envisaged in art.14, items I and II of the CTN and art. 12, § 2, paragraphs “b” and § 3, Law 9,532/97, in conformity with the Constitution. Thus, five legally-established and consubstantiated conditions fundamentally remain in the cumulative obligations of:

1) Final and full application of the entity’s financial resources in the country and on behalf of its not-for-profit, public interest institutional purposes;

2) Non-distribution of any parcel of its assets or of its incomes as profit or result-sharing;

3) Not remunerating, in any manner, its managers for services rendered;

4) Preserve in good order, for five years, counted as from the date of issue, the documents which prove the origin of its revenues and, the effectivation of its expenses, as well as the performing of any other acts or operations which come to change its asset situation, documents which are able to assure the exactness of its accounts;

5) Present, on a yearly basis, an Income Statement according to the dispositions in an act of the Brazilian Federal Revenue.

h) The revocation or act of suspension of immunity by the Federal Tax Administration, requires the postulations of full defense, contradictory, and due legal process, and is conditioned to the ascertaining of the following assumptions of fact, relative to the calendar years in which the beneficent entity has provenly:

1) Not complied with the requirements or conditions envisaged under articles 9, § 1, and 14, CTN;

2) Contributed to the practice of an act which constitutes infringement to the tax legislation device;

3) Falsely informed or stated, omitted or simulated the receipt of donations in goods or in cash;

4) Cooperated for a third party to evade taxes or practice tax illicit acts;

5) Effected the payment, by immune institution, on behalf of its associates or managers, or still, on behalf of partners, shareholders or managers of legal entities to it associated in any manner, of expenses deemed undeductible in determining the tax calculation basis or of the social contribution basis on the net profit.

Thus, either because *the exemption devices of the former Finsocial and of the CSSLL only bear a literal interpretation (art. 111, item II, CTN), not bearing an extensive or analogical interpretation, or in face of the typicity of the Tax Law institutes do not mix immunity and exemption*, there is no doubt that they are *undemandable* and, consequently, should not be observed, for the *enjoyment of immunity by educational and social assistance institutions without profit purposes*, the requirements *instituted for enjoyment of exemption by the former Finsocial and CSSLL, envisaged under art. 55, Law 8,212/91, and consubstantiated in the obligations that the abovementioned institutions: a) be recognized as of federal, state, Federal District, or municipal public utility; b) be holders of the Certificate, or Registration of Entity for Philanthropic Purposes, supplied by the National Social Service Council, renewed every three years; c) promote beneficent social assistance, including educational or health, to minors, senior citizens, handicapped persons, or needy persons; and d) freely promote, and, under exclusive character, the beneficent social assistance to needy persons, especially to children, adolescents, senior citizens and physical deficiency bearers.*

6. Conclusion.

This in-depth study of the tax reality of Brazilian philanthropic entities allows us to carry out a basic comparison with the North-American model.

Following explanation of the North-American and Brazilian realities, with the analysis of the requirements for the enjoyment of tax benefits, the cases of revocation of such benefits and other penalties, in addition to the historical context involving the theme, one reaches the conclusion that there is no perfect system, but that it would be very interesting for Brazil to copy some of the features of the tax benefit model of the North-American entities.

The United States Constitution does not specifically address philanthropy, philanthropic values are rooted in the core values and beliefs of America's Founding Fathers. Thus, we have a tax exemption, not constitutional immunity.

The USA displays a vast tradition of philanthropy contrary to Brazil. Brazil has historically being a paternalistic regime, in which every charitable initiative is expected to flow from the government.

In the USA, not every non-profit organization is a charitable organization, so, the Internal Revenue Code defines many kinds of non-profit organizations which do not pay income tax. However, only charitable organizations can receive tax-deductible contributions and avoid paying property and sales tax.

A USA foundation can be a private or public foundation, but both are an entity established as a nonprofit corporation or a charitable trust, with a principal purpose of making grants to unrelated organizations or institutions or to individuals for scientific, educational, cultural, religious, or other charitable purposes.

The North-American model bears a high concern on the use of philanthropic entities for political purposes, electoral campaigns, lobbying, among others, whereas the Brazilian system does not concern itself to these features.

Donations by individuals and legal entities for such entities are also features of the North-American society, but are not relevant to Brazilian entities.

Control over North-American citizens' inheritances, for donations to philanthropic entities does not serve as a path for tax avoidance receives priority treatment in policy formulation.

There is an interesting empirical study about the optimal treatment of charitable donations which can be used for both systems, that, in short, say that by utilizing a tax preference, we allocate the costs of the services charities perform among individuals in proportion to the value each person places on each charity's programs. The economic reason why we might subsidize through tax preference instead of directly is based on the tax efficiency argument: If the elasticity of charitable donations with respect the tax rate is greater than unity, then, charitable giving increases by, at least, as much as tax revenue declines.

There is a great difference between the two models as to the penalties for enjoyment of tax benefits. Whereas the USA punishes some errors with monetary penalties, or a suspension of the benefit during the year, Brazil is always extreme in analyzing any oversight as it punishes with the revocation of immune conditions status. Such posture, instead of producing the desired system control effects, encourages entity illegality.

However, the greatest contribution that the North-American model could provide to the tax policy drafters and, consequently, to Brazilian tax benefit treatment policy is the strict characterization of the entity as philanthropic, without allowing it to bear for profit purposes and, at the same time, to perform philanthropic activities. To be tax-exempt under according the Internal Revenue Code, an organization must be organized and operated exclusively for exempt purposes, and none of its earnings may inure to any private shareholder or individual. This is the key to system control. The vast majority of Brazilian problems stems from the fact that philanthropic educational entities to reserve vacancy for philanthropy and accrue profits regarding the other vacancies. Along the same path, entities linked to health perform activities not-for-profit only to enjoy the constitutional and legal tax benefits, being extremely profitable in other activities.

Whereas the most new Brazilian law, with the number 12101, of December 2009, does not significantly alter the disturbing picture of nonprofits in Brazil, as I understand, it is imperative to recognize an urgent need for the Union, States and

Municipalities, the immunity of the bodies responsible for the requirements, without this increase in requirements that are set by law or the creation of a difficult customer, otherwise the distortion function and maintaining this absurd number of lawsuits.

Another major contribution would be to import the North American culture to understand that tax money is the great promoter of welfare and quality of life, of the whole population, and therefore, must be preserved and its spending should be inspected. Thus, it is common for charities that should not enjoy exemption are denounced by the common citizen, by other entities or by government itself, with the sole intention of doing what is right. Besides, even the antique tradition of exemption can be re-thought if the welfare or the quality of life can be harmed.

A USA charitable organization must not be organized or operated for the benefit of private interests, such as the creator or the creator's family. In Brazil, it is common that profitable companies, headed by wealthy individuals, with a very high acquisitive power, become philanthropic, clearly to receive tax benefits. This distortion is the basis of all problems faced for the entity to be able to comply with the requirements of its maintenance as philanthropic.

On the other hand, the USA have always acted in the strict legality principle, distinguishing what can be considered as philanthropic activities from what is being used to generate profit.

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