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## Fragmented Oversight of Nonprofits in the United States: Does it Work? Can it Work?

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# FRAGMENTED OVERSIGHT OF NONPROFITS IN THE UNITED STATES: DOES IT WORK? CAN IT WORK?

LLOYD HITOSHI MAYER\*

## INTRODUCTION

Previously Brendan Wilson and I concluded that oversight of non-profit governance would be most effective if it remained the responsibility of the states, although it would benefit from both a federal funding mechanism and enhanced coordination with the Internal Revenue Service.<sup>1</sup> More recently I concluded that oversight of federal tax exemption would be better served if Congress shifted the locus of that oversight to a national, self-regulatory organization working in close cooperation with the IRS given the perennial financial and other limitations faced by the IRS.<sup>2</sup> What neither of these earlier articles addressed, however, was whether the current split of nonprofit oversight between the states and the federal government is itself problematic. This essay seeks to fill that gap, which is particularly appropriate for this symposium because some of the other countries represented here have or are moving towards more centralized structures for providing such oversight.<sup>3</sup>

Part I briefly describes the current United States system for legal oversight of nonprofits, which divides responsibility between the state governments and the federal government. Part II then discusses the

\* Professor, Notre Dame Law School. My deepest thanks to Evelyn Brody and Dana Brakman Reiser for organizing this symposium, to the participants in the symposium and Barry Cushman for helpful comments, and to Erik Adams for research assistance.

1. Lloyd Hitoshi Mayer & Brendan M. Wilson, *Regulating Charities in the Twenty-First Century: An Institutional Analysis*, 85 CHI.-KENT L. REV. 479, 534-49 (2010).

2. Lloyd Hitoshi Mayer, *"The Better Part of Valour is Discretion": Should the IRS Change or Surrender Its Oversight of Tax-Exempt Organizations?*, 7 COLUM. J. TAX L. (forthcoming 2016).

3. See AUSTRALIAN CHARITIES & NOT-FOR-PROFITS COMM'N, NOT-FOR-PROFIT REFORM AND THE AUSTRALIAN GOVERNMENT 13-14 (2013); *About Us*, CHARITY COMM'N FOR ENG. & WALES, <https://www.gov.uk/government/organisations/charity-commission/about> (last visited Jan. 15, 2016); but see GE Dal Pont, *Conceptualizing "Charity" in State Taxation*, 44 AUSTRALIAN TAX REV. 48, 48 (2015) (Australian federal statutory definition of "charity" still distinct from State and Territory common law definition). Such centralization can also be seen in a couple other countries that share a common legal history with the United States, Australia, and the United Kingdom. KERRY O'HALLORAN ET AL., CHARITY LAW & SOCIAL POLICY: NATIONAL AND INTERNATIONAL PERSPECTIVES ON THE FUNCTIONS OF THE LAW RELATING TO CHARITIES 349, 391 (2008) (Singapore and New Zealand).

advantages and disadvantages of such fragmented oversight, drawing on the recent academic literature exploring fragmentation in a variety of contexts and then applying the lessons from that literature specifically to oversight of nonprofits. Part III makes several recommendations for enhancing the advantages and minimizing the disadvantages of fragmentation in the nonprofit context, which if fully implemented likely would render such fragmented oversight at least as effective as oversight centralized in a single, national actor. These recommendations include continuing to consolidate information gathering at the IRS, addressing the perennial lack of resources in this area through a national funding mechanism, improving coordination while maintaining fragmented authority over duty of loyalty and charitable solicitation issues, and either halting or rolling back the federal government's encroachment on duty of care issues.

### I. THE CURRENT UNITED STATES SYSTEM

In the United States both state governments and the federal government oversee nonprofits.<sup>4</sup> At the state level the attorney general usually is the primary actor, although other state agencies may also have various roles.<sup>5</sup> At the federal level the Internal Revenue Service is the primary actor, although several other federal agencies have more limited oversight functions.<sup>6</sup> For the most part private parties do not have a direct role in enforcing legal rules as against nonprofits, although private parties can bring apparent violations to the attention of the appropriate government officials.<sup>7</sup> A number of private parties also

4. See generally MARION R. FREMONT-SMITH, GOVERNING NONPROFIT ORGANIZATIONS: FEDERAL AND STATE LAW AND REGULATION 301-427 (2004); Evelyn Brody, *The Legal Framework for Nonprofit Organizations*, in THE NONPROFIT SECTOR: A RESEARCH HANDBOOK 243, 249-53 (Walter W. Powell & Richard Steinberg eds., 2006) [hereinafter RESEARCH HANDBOOK].

5. See FREMONT-SMITH, *supra* note 4, at 301 (attorney general), 364-65 (secretaries of state and corporation commissions), 368-70 (departments of tax and revenue), 372-73 (consumer protection agencies).

6. See U.S. GEN. ACCOUNTING OFF., GAO-02-526, TAX-EXEMPT ORGANIZATIONS: IMPROVEMENTS POSSIBLE IN PUBLIC, IRS, AND STATE OVERSIGHT OF CHARITIES 55-71 (2002) [hereinafter GAO 2002 REPORT].

7. See JAMES J. FISHMAN ET AL., NONPROFIT ORGANIZATIONS: CASES AND MATERIALS 511-12 (5th ed. 2015) (lack of standing by third parties to challenge federal tax-exempt status); FREMONT-SMITH, *supra* note 4, at 324-36 (lack of standing by private parties to enforce state law fiduciary duties, with limited exceptions); Mary Grace Blasko et al., *Standing to Sue in the Charitable Sector*, 28 U.S.F. L. REV. 37, 52-61 (1993) (exceptions to general lack of standing); Brody, *supra* note 4, at 252-53 (lack of standing to enforce fiduciary duties).

have worked with government agencies in various cooperative oversight efforts.<sup>8</sup>

### A. *The Role of State Governments*

State governments have historically had authority to oversee nonprofits in at least four distinctive ways. First, state law provides the legal forms for nonprofits and imposes the related fiduciary duties on governing board members and officers.<sup>9</sup> While oversight of formation by state secretaries of state has become essentially ministerial, attorneys general continue to exercise more discretionary authority with respect to enforcing governance duties such as the duty of care, the duty of loyalty, and the duty of obedience.<sup>10</sup> Second, attorneys general commonly have responsibility for ensuring that charitable assets, which are usually controlled by nonprofits, remain dedicated to charitable purposes.<sup>11</sup> Third, most states oversee charitable solicitations as part of their broader consumer protection role, although the specific state agency with this responsibility varies from state to state.<sup>12</sup> Fourth and finally, states often grant at least some nonprofits exemption from income, property, sales, and other taxes, subject to various conditions and under the oversight of their revenue or tax offices.<sup>13</sup>

Some states choose, however, not to exercise some of this authority. For example, some attorney general offices do not dedicate any resources to overseeing nonprofits or their assets,<sup>14</sup> a number of states

8. See *infra* notes 42–46 and accompanying text.

9. See Garry W. Jenkins, *Incorporation Choice, Uniformity, and the Reform of Nonprofit State Law*, 41 GA. L. REV. 1113, 1124–26 (2007).

10. See Mark Sidel, *The Nonprofit Sector and the New State Activism*, 100 MICH. L. REV. 1312, 1317 (2002); Norman I. Silber, *Nonprofit Interjurisdictionality*, 80 CHI.-KENT L. REV. 613, 620–21 (2005); Linda Sugin, *Resisting the Corporatization of Nonprofit Governance: Transforming Obedience into Fidelity*, 76 FORDHAM L. REV. 893, 899–901 (2007).

11. See MODEL PROTECTION OF CHARITABLE ASSETS ACT, 1 (2011); FREMONT-SMITH, *supra* note 4, at 305–06.

12. See FREMONT-SMITH, *supra* note 4, at 372–73; Robert T. Esposito, *Charitable Solicitation Acts: Maslow's Hammer for Regulating Social Enterprise*, 11 N.Y.U. J.L. & BUS. 463, 470–71 (2015); Charles Nave, *Charitable State Registration and the Dormant Commerce Clause*, 31 WM. MITCHELL L. REV. 227, 227–28, 227 n.1 (2004); Dana Brakman Reiser, *Enron.org: Why Sarbanes-Oxley Will Not Ensure Comprehensive Nonprofit Accountability*, 38 U.C. DAVIS L. REV. 205, 235–36, 235 n.97 (2004).

13. See FREMONT-SMITH, *supra* note 4, at 368–70; FRANCES R. HILL & BARBARA L. KIRSCHTEN, FEDERAL AND STATE TAXATION OF EXEMPT ORGANIZATIONS 14-4 to 14-5 (1994 & Supp. 1996); Evelyn Brody, *All Charities Are Property-Tax Exempt, but Some Charities Are More Exempt Than Others*, 44 NEW ENG. L. REV. 621, 671–732 (2010); Mark J. Cowan, *Nonprofits and the Sales and Use Tax*, 9 FLA. TAX REV. 1077, 1205–45 (2010).

14. See Jenkins, *supra* note 9, at 1128–29.

do not require any reporting or registrations specifically tied to charitable solicitations,<sup>15</sup> and some states automatically provide tax exemptions to nonprofits that successfully obtain certain types of federal tax exemption.<sup>16</sup> Even in those states with active charity oversight offices, resources are stretched thin, and it is not uncommon for commentators to complain that those offices select their enforcement targets based not on policy but politics.<sup>17</sup> Moreover, in some states oversight authority is split between various offices and the extent of coordination between those offices varies significantly.<sup>18</sup>

The states that choose to exercise some or all of this authority have two formal fora to facilitate cooperation with each other, as well as with the federal government and private parties: the National Association of State Charity Officials (NASCO);<sup>19</sup> and the Charities Regulation and Oversight Project of the National State Attorneys General Program at Columbia Law School.<sup>20</sup> The latter endeavor also provides training for state charity officials and supports, in cooperation with the Urban Institute, research into the exact extent of state oversight of nonprofits.<sup>21</sup>

While most non-federal oversight occurs at the state level, local governments often exercise authority in two limited areas. With respect to property tax exemptions, local governments usually determine whether property owned by a nonprofit qualifies under the state law standard for exemption.<sup>22</sup> And many local governments impose chari-

15. See FREMONT-SMITH, *supra* note 4, at 372, 374; Putnam Barber, *Regulation of US Charitable Solicitations Since 1954*, 23 VOLUNTAS 737, 739 (2012); THE MULTI-STATE FILER PROJECT, THE UNIFIED REGISTRATION STATEMENT, [http://multistatefiling.org/index.html#yes\\_states](http://multistatefiling.org/index.html#yes_states) (last visited Jan. 15, 2016).

16. See FREMONT-SMITH, *supra* note 4, at 368, 369; HILL & KIRSCHTEN, *supra* note 13, at 14-5, 14-16.

17. See Blasko et al., *supra* note 7, at 48-49; Evelyn Brody, *Why Public? Parochialism and Paternalism in State Charity Law Enforcement*, 79 IND. L.J. 937, 947-48 (2004); Jenkins, *supra* note 9, at 1128-30.

18. See Memorandum from Peter Swords & Harriet Bograd, Nonprofit Coordinating Comm. of N.Y. 3-4 (Mar. 31, 1997) (on file with author); *supra* note 5 and accompanying text.

19. About, NAT'L ASS'N OF ST. CHARITY OFFICIALS, <http://www.nasconet.org/about/> (last visited Jan. 15, 2016).

20. See *Charities Regulation and Oversight Project*, NAT'L ST. ATTORNEYS GEN. PROG., <http://web.law.columbia.edu/attorneys-general/policy-areas/charities-law-project> (last visited Jan. 15, 2016).

21. See *id.*; Alex Daniels, *Nonprofits Proliferate but Not the Regulators, Says Report*, CHRON. OF PHILANTHROPY (Oct. 5, 2015), <https://philanthropy.com/article/Nonprofits-Proliferate-but-Not/233641>.

22. See Brody, *supra* note 13, at 625.

table solicitation reporting, registration, and other obligations that are in addition to any state-level requirements.<sup>23</sup>

### *B. The Role of the Federal Government*

The federal government had little to no role in overseeing nonprofits prior to the twentieth century.<sup>24</sup> This began to change with the permanent establishment of the federal income tax in 1913 and the related exemptions from that tax for many types of nonprofits.<sup>25</sup> These exemptions, and the charitable contribution deductions Congress added shortly thereafter, necessarily grant the Internal Revenue Service the authority to determine whether nonprofits and their donors qualify for these tax benefits.<sup>26</sup> These benefits also give the federal government the authority to oversee any aspect of nonprofits that is reasonably related to those qualifications, which has led over the years to an expansion of federal government oversight into areas also overseen by the states.<sup>27</sup>

More specifically, in 1969 Congress enacted a series of limits on the activities of private foundations that went beyond state law requirements.<sup>28</sup> Private foundations are a subset of charities characterized by having a very limited group of financial supporters and lacking other characteristics indicating accountability to the public; Congress enacted these limits to ensure a minimum level of charitable activity and prevent misuse of charitable assets.<sup>29</sup> Congress also empowered

23. See, e.g., CAL. ATT'Y GEN., GUIDE FOR CHARITIES 28 (2005), [http://oag.ca.gov/sites/all/files/agweb/pdfs/charities/publications/guide\\_for\\_charities.pdf](http://oag.ca.gov/sites/all/files/agweb/pdfs/charities/publications/guide_for_charities.pdf)? (more than 200 cities and counties in California have charitable solicitation ordinances).

24. See Jenkins, *supra* note 9, at 1123–24.

25. See FREMONT-SMITH, *supra* note 4, at 56. Several earlier versions of the federal income tax included exemptions for certain nonprofits, but those versions were relatively short-lived and so did not result in a significant federal oversight role with respect to nonprofits. See *id.*

26. See I.R.C. §§ 170(a), (c), 501, 642(c), 2055, 2522 (2015); Terri Lynn Helge, *Policing the Good Guys: Regulation of the Charitable Sector Through a Federal Charity Oversight Board*, 19 CORNELL J. L & PUB. POL'Y 1, 17–18 (2009).

27. See BONNIE S. BRIER ET AL., ADVISORY COMM. ON TAX EXEMPT & GOV'T ENTITIES, REPORT OF RECOMMENDATIONS, THE APPROPRIATE ROLE OF THE INTERNAL REVENUE SERVICE WITH RESPECT TO TAX-EXEMPT ORGANIZATION GOOD GOVERNANCE ISSUES 42 (2008); Silber, *supra* note 10, at 624–29; but see James J. Fishman, *Stealth Preemption: The IRS's Nonprofit Corporate Governance Initiative*, 29 VA. TAX REV. 545, 586–89 (2010) (questioning the constitutionality of this expansion, at least to the extent it has been through informal pronouncements).

28. See Tax Reform Act of 1969, Pub. L. No. 91-172, § 101, 83 Stat. 487, 492-536 (1969) (codified at various sections of the I.R.C.).

29. See H.R. REP. No. 91-431, pt. 1, at 4 (1969); S. REP. No. 91-552, at 6 (1969); see generally Nina J. Crimm, *A Case Study of a Private Foundation's Governance and Self-Interested Fiduciaries*

state authorities to enforce these new rules by requiring that all private foundations incorporate these rules into their governing documents.<sup>30</sup>

In 1996 Congress empowered the IRS to impose excise taxes on insiders of charities and social welfare organizations who benefit from overly generous financial transactions with their organizations and on managers who knowingly approve such transactions.<sup>31</sup> Congress did this even though such transactions likely already violated the state law duties of loyalty (for the benefitting insiders) and of care (for the managers).<sup>32</sup> These excise taxes, known as “intermediate sanctions,” provided the IRS with a new enforcement tool with respect to such transactions; previously such transactions likely violated the existing prohibition on private inurement that has long applied to charities and several other types of tax-exempt nonprofits, but the only available penalty was the draconian (and therefore rarely invoked) one of revocation of tax-exempt status.<sup>33</sup> Finally, in the late 2000s the IRS both developed a set of governance best practices and expanded the annual information return required for most tax-exempt nonprofits with significant income or assets (the Form 990) by adding a series of questions relating to governance practices such as independent directors, conflicts of interest, and whistleblowing even though federal law and most state laws do not mandate such practices.<sup>34</sup>

Several other federal agencies also have oversight over certain nonprofit-related activities, although their coordination with the IRS is limited.<sup>35</sup> The federal government and the states also cooperate to a

*Calls for Further Regulation*, 50 EMORY L.J. 1093, 1118–23 (2001); Thomas A. Troyer, *The 1969 Private Foundation Law: Historical Perspective on Its Origins and Underpinnings*, 27 EXEMPT ORG. TAX REV. 52 (2000).

30. See Tax Reform Act of 1969, Pub. L. No. 91-172, § 101(a), 83 Stat. 487, 496 (1969) (codified at I.R.C. § 508(e) (2006)); H.R. REP. No. 91-431, pt. 1, at 40; S. REP. 91-552, at 56.

31. See Taxpayer Bill of Rights 2, Pub. L. No. 104-168, § 1311, 110 Stat. 1452, 1475-79 (1996); H.R. REP. No. 104-506, at 56 (1996). Charities are generally tax-exempt under I.R.C. § 501(c)(3), and social welfare organizations are generally tax-exempt under I.R.C. § 501(c)(4). See I.R.C. § 501(a), (c).

32. See Evelyn Brody, *The Limits of Charity Fiduciary Law*, 57 MD. L. REV. 1400, 1437–39 (1998); Marion R. Fremont-Smith, *The Search for Greater Accountability of Nonprofit Organizations: Recent Legal Developments and Proposals for Change*, 76 FORDHAM L. REV. 609, 633–34 (2007).

33. See James J. Fishman, *Improving Charitable Accountability*, 62 MD. L. REV. 218, 253–54 (2003).

34. See I.R.S. Form 990, at 6 (2014); BRIER ET AL., *supra* note 27, at 35–37; *Governance of Charitable Organizations and Related Topics*, INTERNAL REVENUE SERV., <https://www.irs.gov/Charities-&-Non-Profits/Governance-of-Charitable-Organizations-and-Related-Topics> (last visited Jan. 15, 2016).

35. See GAO 2002 REPORT, *supra* note 6, at 69–71.

limited extent. For example, the IRS has processes in place to share information with certain state agencies, although those processes are limited by federal taxpayer privacy rules.<sup>36</sup> Other federal agencies with limited jurisdiction over nonprofit-related activities may also work with their state counterparts. For example, the Federal Trade Commission (which has jurisdiction over for-profit fundraisers but not charities<sup>37</sup>) and all fifty state attorneys general recently announced their joint investigation into the fundraising practices of several purported charities and their for-profit fundraisers.<sup>38</sup>

### C. The Role of Private Parties

There are numerous private parties that seek to improve the practices of nonprofits, including compliance with applicable laws. These entities include self-regulatory organizations, watchdog groups, and various associations of nonprofits, as well as donors, members, and beneficiaries. In general such parties do not have the ability to directly enforce applicable nonprofit laws.<sup>39</sup> This inability usually is manifested by judicial decisions concluding that these parties lack standing to bring claims alleging such violations in court, although in some states there are narrow exceptions to this general rule.<sup>40</sup>

What these entities and indeed any private party can do instead is bring apparent violations to the attention of the public and the appropriate government officials.<sup>41</sup> There also are several examples of more extensive cooperation between private parties and government agen-

36. See U.S. GOV'T ACCOUNTABILITY OFF., GAO-15-164, TAX-EXEMPT ORGANIZATIONS: BETTER COMPLIANCE INDICATORS AND DATA, AND MORE COLLABORATION WITH STATE REGULATORS WOULD STRENGTHEN OVERSIGHT OF CHARITABLE ORGANIZATIONS 36-38 (2014) [hereinafter GAO 2014 REPORT].

37. See FREMONT-SMITH, *supra* note 4, at 424-25.

38. See Press Release, Fed. Trade Comm'n, FTC, All 50 States and D.C. Charge Four Cancer Charities with Bilking Over \$187 Million from Consumers (May 19, 2015), <https://www.ftc.gov/news-events/press-releases/2015/05/ftc-all-50-states-dc-charge-four-cancer-charities-bilking-over>.

39. See Rob Atkinson, *Unsettled Standing: Who (Else) Should Enforce the Duties of Charitable Fiduciaries*, 23 J. CORP. L. 655, 657 (1998); Geoffrey A. Manne, *Agency Costs and the Oversight of Charitable Organizations*, 1999 WIS. L. REV. 227, 240-50 (1999).

40. See Linda Sugin, *Strengthening Charity Law: Replacing Media Oversight with Advance Rulings for Nonprofit Fiduciaries*, 89 TUL. L. REV. 869, 876, 879, 879 n.46 (2015); sources cited *supra* note 7.

41. See, e.g., *IRS Complaint Process - Tax-Exempt Organizations*, INTERNAL REVENUE SERV., <https://www.irs.gov/Charities-&-Non-Profits/IRS-Complaint-Process-Tax-Exempt-Organizations> (last updated June 9, 2015); ST. OF CAL., DEP'T OF JUST., COMPLAINT TO THE CALIFORNIA ATTORNEY GENERAL REGARDING A CHARITY OR CHARITABLE SOLICITATION, <https://oag.ca.gov/sites/all/files/agweb/pdfs/charities/charitable/ct9.pdf>; N. Y. ST. DEP'T OF LAW CHARITIES BUREAU, COMPLAINT/INQUIRY FORM, <http://www.charitiesnys.com/pdfs/char030.pdf>.



cies with respect to nonprofit oversight. In 1980 the IRS formed the Tax Forms Coordinating Committee with both state charity officials and representatives of charities to help revise the Form 990.<sup>42</sup> In the 1990s a charity launched GuideStar.org to make publicly available the Form 990 series annual information returns for all tax-exempt nonprofits, which the charity obtains directly from the IRS.<sup>43</sup> This charity also worked with NASCO on the creation of a single Internet portal for state charitable registration, funded in part by the U.S. Department of Commerce, although that project has not yet been completed.<sup>44</sup> The Urban Institute's Center on Nonprofits and Philanthropy has been at the forefront of helping both the IRS and state charity officials facilitate e-filing of their various forms.<sup>45</sup> Finally, for almost fifteen years the IRS has had an Advisory Committee on Tax-Exempt and Government Entities that includes private individuals knowledgeable about tax-exempt nonprofits, although the IRS recently reduced the size and scope of that Committee.<sup>46</sup>

## II. DOES (OR CAN) FRAGMENTED OVERSIGHT OF NONPROFITS WORK?

As Part I details, regulatory oversight of nonprofits is divided between the state and federal governments and also divided within some states and, to a lesser extent, within the federal government. The issue these divisions raise is whether they strengthen or weaken that oversight, as compared to alternative structures. This Part draws on the growing literature addressing such fragmentation of oversight in other contexts to identify possible advantages and disadvantages and then considers the extent to which such advantages and disadvantages exist

42. See ERIC B. CARRIKER ET AL., ADVISORY COMM. ON TAX EXEMPT & GOV'T ENTITIES, 2013 REPORT OF RECOMMENDATIONS, EXEMPT ORGANIZATIONS: LEVERAGING LIMITED IRS RESOURCES IN THE TAX ADMINISTRATION OF SMALL TAX-EXEMPT ORGANIZATIONS 7-8 (2013).

43. See *GuideStar: A Brief History*, GUIDESTAR, <http://www.guidestar.org/rxg/about-us/history.aspx> (last updated Jan. 19, 2016).

44. See Press Release, GuideStar, Federal Grant to GuideStar Funds Creation of National Charity Registry (Oct. 14, 2003), <http://www.guidestar.org/rxa/news/news-releases/2003/federal-grant-to-guidestar-funds-creation-of-national-charity-registry.aspx>; *Single Portal: New Website and Request for Information Now Available*, NASCO, <http://www.nasconet.org/category/single-portal/> (last visited Jan. 15, 2016).

45. See *Form 990 Online*, NAT'L CTR. FOR CHARITABLE STATISTICS, <http://efile.form990.org/> (last modified Mar. 8, 2016).

46. See *Advisory Committee on Tax Exempt and Government Entities*, INTERNAL REVENUE SERV., [https://www.irs.gov/Government-Entities/Advisory-Committee-on-Tax-Exempt-and-Government-Entities-\(ACT\)](https://www.irs.gov/Government-Entities/Advisory-Committee-on-Tax-Exempt-and-Government-Entities-(ACT)) (last visited Jan. 15, 2016); *IRS Makes Changes to Its Advisory Committee on Tax Exempt and Government Entities (ACT)*, INTERNAL REVENUE SERV., <https://www.irs.gov/Government-Entities/IRS-Makes-Changes-to-Its-Advisory-Committee-on-Tax-Exempt-and-Government-Entities-ACT> (last updated Jan. 19, 2016).

in the nonprofit context. While Norm Silber considered this issue ten years ago, he did not have the advantage of the extensive academic literature relating to it that has emerged since then.<sup>47</sup> In the interest of brevity, examples from these other contexts are not included but can be accessed through the citations provided in the footnotes.

For purposes of this analysis it is assumed that the criteria for evaluating regulatory oversight are the generally accepted ones of effectiveness in achieving regulatory goals, efficiency, and accountability to our democratic political system and the public.<sup>48</sup> It is also assumed that the regulatory goals and therefore the substantive law governing nonprofits, are the current ones.<sup>49</sup> In other words, this essay is limited to addressing the *who* and *how*, not the *what*, of nonprofit oversight.

### *A. Potential Advantages & Disadvantages of Fragmentation*

There are numerous legal contexts where authority is split between state governments and the federal government. Some of the most prominent areas are the regulation of elections, the environment, and securities.<sup>50</sup> There are also many contexts where oversight authority only resides at one level of government but is split at that level among different agencies, such as immigration and national security intelligence gathering at the federal level.<sup>51</sup> And, of course, in some contexts oversight authority is split both between levels of government and between different agencies within a given level, as is the case for nonprofits. Scholars who have considered this issue have identified a

47. See Silber, *supra* note 10, at 633–34.

48. See Jody Freeman & Jim Rossi, *Agency Coordination in Shared Regulatory Space*, 125 HARV. L. REV. 1131, 1181 (2012). These goals can be stated in slightly different ways and could be expanded to include equity or fairness concerns if appropriate for the context. See, e.g., Alejandro E. Camacho & Robert L. Glicksman, *Functional Government in 3-D: A Framework for Evaluating Allocations of Government Authority*, 51 HARV. J. LEG. 19, 27 (2014) (including equity and using “legitimacy” in place of accountability); Eric J. Pan, *Structural Reform of Financial Regulation*, 19 TRANSNAT’L L. & CONTEMP. PROBS. 796, 808 (2011) (separately listing “accountability” and “legitimacy” and using “competency” in place of effectiveness).

49. See generally John Simon et al., *The Federal Tax Treatment of Charitable Organizations*, in RESEARCH HANDBOOK, *supra* note 4, at 267, 267 (policy goals of federal tax rules for charities).

50. See Jonathan H. Adler, *When Is Two a Crowd? The Impact of Federal Action on State Environmental Regulation*, 31 HARV. ENVTL. L. REV. 67 (2007); Derek T. Muller, *The Play in the Joints of the Election Clauses*, 13 ELECTION L.J. 310 (2014); Pan, *supra* note 48, at 837–41 (securities).

51. See Stephen Lee, *Monitoring Immigration Enforcement*, 53 ARIZ. L. REV. 1089, 1110–13 (2011); Anne Joseph O’Connell, *The Architecture of Smart Intelligence: Structuring and Overseeing Agencies in the Post-9/11 World*, 94 CAL. L. REV. 1655, 1660–62 (2006). At least at the federal level such fragmentation may be pervasive. See U.S. GOV’T ACCOUNTABILITY OFF., GAO-11-318SP, OPPORTUNITIES TO REDUCE POTENTIAL DUPLICATION IN GOVERNMENT PROGRAMS, SAVE TAX DOLLARS, AND ENHANCE REVENUE 1-2 (2011) [hereinafter GAO 2011 REPORT]; Freeman & Rossi, *supra* note 48, at 1134; Jason Marisam, *Duplicative Delegations*, 63 ADMIN. L. REV. 181, 182 (2011).

number of possible advantages and disadvantages of such fragmentation. Their analyses also reveal that the extent to which possible advantages and disadvantages of fragmentation actually exist tends to be context sensitive.<sup>52</sup>

Before considering the potential advantages and disadvantages of fragmentation, it is important to note that these only apply if the allocation of oversight authority is such that the actions of one government body likely will interact with the actions of another body. The most obvious situation where this occurs is when two (or more) government bodies have jurisdiction over the same substantive area and perform the same functional role in that area.<sup>53</sup> Less obvious situations include when two government bodies have distinct substantive jurisdictions or functional roles but those jurisdictions or roles are closely related to each other.<sup>54</sup>

### 1. Potential Advantages

Commonly cited potential advantages of fragmentation<sup>55</sup> are: a reduced chance of under regulation or other errors, including a reduced chance of missing important issues or instances of noncompliance;<sup>56</sup> a reduced chance of agency capture by interest groups;<sup>57</sup> in-

52. See Camacho & Glicksman, *supra* note 48, at 83; Freeman & Rossi, *supra* note 48, at 1138–39; O’Connell, *supra* note 51, at 1683. Discussions of the advantages and disadvantages of fragmentation when it involves both states and the federal government can also be found in the extensive academic literature relating to federalism. See Heather Gerken, *Federalism and Nationalism: Time for a Détente*, 59 ST. LOUIS U. L.J. 997, 1004, 1004 nn.22–23 (2015).

53. See Freeman & Rossi, *supra* note 48, at 1145.

54. See *id.*; see also GAO 2011 REPORT, *supra* note 51, at 336 (distinguishing between “duplication” (same activities/services to same beneficiaries), “overlap” (“similar goals, engage in similar activities or strategies to achieve them, or target similar beneficiaries”), and “fragmentation” (“involved in the same broad area”)); Jacob E. Gersen, *Overlapping and Underlapping Jurisdiction in Administrative Law*, 2006 SUP. CT. REV. 201, 208–11 (2006) (potential allocations of authority as between two governmental units).

55. See generally Camacho & Glicksman, *supra* note 48, at 51–53; Freeman & Rossi, *supra* note 48, at 1142–43, 1151; Neal Kumar Katyal, *Internal Separation of Powers: Checking Today’s Most Dangerous Branch from Within*, 115 YALE L.J. 2314, 2324–26 (2006).

56. See, e.g., Todd S. Aagaard, *Regulatory Overlap, Overlapping Legal Fields, and Statutory Discontinuities*, 29 VA. ENVTL. L.J. 237, 292–94, 298–99 (2011); O’Connell, *supra* note 51, at 1678–79; Nancy Staudt, *Redundant Tax and Spending Programs*, 100 NW. U. L. REV. 1197, 1222–24 (2006); Manning Gilbert Warren III, *Reflections on Dual Regulation of Securities: A Case Against Preemption*, 25 B.C. L. REV. 495, 532–33 (1984).

57. See, e.g., Aagaard, *supra* note 56, at 294–95; Roberta S. Karmel, *Reconciling Federal and State Interests in Securities Regulation in the United States and Europe*, 28 BROOK. J. INT’L L. 495, 544 (2003); O’Connell, *supra* note 51, at 1677; Jared Elost, Note, *Dynamic Federalism and Consumer Financial Protection: How the Dodd-Frank Act Changes the Preemption Debate*, 89 N.C. L. REV. 1273, 1296–97 (2011); Jared P. Roscoe, Note, *State Courts and the Preemption Against Banking Preemption*, 67 N.Y.U. ANN. SURV. AM. L. 309, 331–35 (2011).

creased regulatory experimentation because of competition;<sup>58</sup> greater development of expertise and relevant information;<sup>59</sup> the ability to take advantage of differences to allocate substantive jurisdiction and/or functional roles to the agency best suited to exercise them;<sup>60</sup> and reduced monitoring costs for political overseers and the public.<sup>61</sup> The first three goals relate primarily to effectiveness, the next two to efficiency, and the last one to accountability.<sup>62</sup> If the fragmentation includes authority allocated to state or local governments, additional potential advantages include leveraging local knowledge and expertise to better tailor oversight to local conditions and preferences, thereby improving effectiveness and possibly efficiency.<sup>63</sup>

## 2. Potential Disadvantages

Commonly cited potential disadvantages of fragmentation<sup>64</sup> are: increased chance of under regulation, including both the potential for races to the bottom<sup>65</sup> and the increased chance of missing important issues or instances of noncompliance because one agency assumes another agency will address them or because a federal agency or a large state agency crowds out other efforts;<sup>66</sup> increased chance of overregulation, including possibly inconsistent demands and increased uncertainty as a result;<sup>67</sup> lack of uniformity;<sup>68</sup> duplication of efforts, and therefore of agency costs and compliance burdens;<sup>69</sup> increased costs

58. See, e.g., Aagaard, *supra* note 56, at 295; O'Connell, *supra* note 51, at 1677-78; Pan, *supra* note 48, at 812-14; Elizabeth R. Schiltz, *Damming Watters: Channeling the Power of Federal Preemption of State Consumer Banking Laws*, 35 FLA. ST. U. L. REV. 893, 935-36 (2008); Staudt, *supra* note 56, at 1228-30.

59. See, e.g., Gersen, *supra* note 54, at 212-14; Staudt, *supra* note 56, at 1227-28; Matthew C. Stephenson, *Information Acquisition and Institutional Design*, 124 HARV. L. REV. 1422, 1463-68, 1474-79 (2011); Warren, *supra* note 56, at 531.

60. See, e.g., Freeman & Rossi, *supra* note 48, at 1146.

61. See, e.g., Gersen, *supra* note 54, at 214; Michael M. Ting, *A Strategic Theory of Bureaucratic Redundancy*, 47 AM. J. POL. SCI. 274, 274-75 (2003).

62. See Freeman & Rossi, *supra* note 48, at 1181-91.

63. See Camacho & Glicksman, *supra* note 48, at 40-41; Schiltz, *supra* note 58, at 937-38.

64. See generally Aagaard, *supra* note 56, at 286-88; Camacho & Glicksman, *supra* note 48, at 48-50; Freeman & Rossi, *supra* note 48, at 1135, 1150-51; Marisam, *supra* note 51, at 223-24; Staudt, *supra* note 56, at 1208-14.

65. See, e.g., Pan, *supra* note 48, at 813; Roscoe, *supra* note 57, at 330.

66. See, e.g., Adler, *supra* note 50, at 94; Gersen, *supra* note 54, at 214; O'Connell, *supra* note 51, at 1680.

67. See, e.g., Pan, *supra* note 48, at 841-42; Warren, *supra* note 56, at 527-28.

68. See, e.g., Karmel, *supra* note 57, at 544; Warren, *supra* note 56, at 533-34; Elost, *supra* note 57, at 1291-92.

69. See, e.g., Gersen, *supra* note 54, at 214; Karmel, *supra* note 57, at 544; O'Connell, *supra* note 51, at 1679-80; Pan, *supra* note 48, at 842; Roscoe, *supra* note 57, at 335.

because of reduced economies of scale;<sup>70</sup> increased costs from the need to coordinate;<sup>71</sup> and a lack of accountability because one agency is able to blame other agencies for failures. The first three goals relate primarily to effectiveness, the next three to efficiency, and the last one to accountability. If the fragmentation includes authority allocated to state or local governments, additional potential disadvantages include the increased chance of under regulation because costs of under regulation mainly fall outside of the relevant jurisdiction and the increased risk of capture by state or local interest groups.<sup>72</sup>

### 3. Determining Actual Advantages and Disadvantages

The major difficulty when attempting to evaluate fragmentation in a given context is that it may be hard to compare the identified, existing advantages and disadvantages to what would exist in a hypothetical, less fragmented situation that likely has either never existed or only existed at a much different time. For example, the federal government has never had exclusive oversight of nonprofits, and while oversight of nonprofits may have resided exclusively or almost exclusively with the states prior to 1913, the nonprofit sector (and the world) was a very different place then. That said, it may be possible to determine that the advantages of fragmentation are significantly greater than the disadvantages of fragmentation, such that it is unlikely a less fragmented system would be a significant improvement (especially given transition costs). Even if that is not the case, careful consideration of the advantages and disadvantages may reveal ways to increase the advantages and decrease the disadvantages so as to reach this state.

#### *B. Actual Advantages & Disadvantages of Fragmentation with Respect to Oversight of Nonprofits*

As Part I described, states and the federal government share oversight authority with respect to nonprofits. Some of this sharing reflects a division of responsibilities, however, as opposed to an overlap of responsibilities. This Part therefore first parses through the various responsibilities of the states and the federal government to determine to

70. See, e.g., O'Connell, *supra* note 51, at 1680.

71. See, e.g., *id.* at 1680–82; Brian D. Shannon, *Debarment and Suspension Revisited: Fewer Eggs in the Basket?*, 44 CATH. U. L. REV. 363, 384–85 (1995).

72. See, e.g., Camacho & Glicksman, *supra* note 48, at 43–44.

what extent there are actual overlaps. It then considers to what extent this sharing and division of responsibilities leads to the potential advantages and disadvantages identified in Part II.A above.

### 1. Divisions and Overlaps

The states have exclusive authority with respect to creation of new nonprofits, although they now only require that new nonprofit entities meet relatively minimal requirements.<sup>73</sup> These requirements include that nonprofits satisfy the nondistribution constraint that prohibits the distribution of profits, although the federal government also imposes this requirement on most nonprofit organizations seeking tax-exempt status through the prohibition on private inurement.<sup>74</sup> The federal government also imposes some specific governing document requirements on nonprofits seeking tax exemption as charities.<sup>75</sup>

The states also have exclusive authority over qualifying for exemptions from state taxes, although many states incorporate exemption from federal income tax into those qualifications and in some instances make federal exemption the only requirement.<sup>76</sup> Similarly, while states have exclusive authority to decide whether a given nonprofit qualifies to receive charitable contributions that may be deducted by donors for state tax purposes, many states that permit such a deduction rely on the federal government's determination that such a deduction is permitted for federal tax purposes.<sup>77</sup> The federal government in turn has exclusive authority with respect to federal income tax exemption and eligibility to receive charitable contributions that may be deducted by donors for federal income tax purposes or federal estate and gift tax purposes.<sup>78</sup>

In certain other areas, however, the states and the federal government have overlapping authority both substantively and functionally. With respect to the fiduciary duties of governing board members and officers, the states have broad authority to impose such duties and

73. See *supra* notes 9–10 and accompanying text.

74. See I.R.C. § 501(c) (prohibiting private inurement for tax-exempt organizations described in paragraphs (3), (4), (6), (7), (9), (11), (13), (19), (26), and (29) of this subsection); Henry Hansmann, *The Role of Nonprofit Enterprise*, 89 *YALE L.J.* 835, 838–39 (1980) (nondistribution constraint under state law).

75. See Treas. Reg. § 1.501(c)(3)-1(b) (2014).

76. See *supra* notes 13, 16 and accompanying text.

77. See Jon Bakija, *Tax Policy and Philanthropy: A Primer on the Empirical Evidence for the United States and Its Implications*, 80 *SOC. RES.* 557, 557 (2013).

78. See *supra* notes 25–27 and accompanying text.

enforce them, including the ability to seek equitable remedies, and almost all of the states exercise this authority to at least some degree.<sup>79</sup> As noted previously, the federal government has also now established some similar duties through excise tax regimes, one set applicable to private foundations that goes beyond the requirements of state law and another set (intermediate sanctions) applicable to charities and social welfare organizations that, for the most part, imposes the same duties as state law.<sup>80</sup> While those duties are only directly enforceable through monetary payments, in practice the IRS can and sometimes does require more equitable type remedies (such as resignations of governing body members or governance structure changes) by threatening to otherwise require larger monetary payments or to revoke an organization's exemption.<sup>81</sup> Certain governance-related duties continue to primarily be imposed and enforced by the states, however, including the duty of care (except with respect to private foundations in some respects) and the duty of obedience to the nonprofit's mission.<sup>82</sup> The federal government has, however, begun encouraging a set of best practices relating to fiduciary duties, even though these practices are generally not required by federal law or most states.<sup>83</sup> Related to the duty of obedience, states have the broadest authority when it comes to the use of a nonprofit's assets, particularly if the nonprofit is charitable, although the federal government also has a limited role with respect to charities in that it imposes a governing document dissolution clause requirement.<sup>84</sup>

With respect to charitable solicitations, the states have the broadest authority, although, as noted above, the FTC also has some authority in this area.<sup>85</sup> Within the states local governments may also exercise separate authority in this area.<sup>86</sup> States and their local governments also share authority with respect to property tax exemptions, but they

79. See *supra* notes 10, 14 and accompanying text.

80. See Silber, *supra* note 10, at 625–26; *supra* notes 29, 31, 32 and accompanying text.

81. See, e.g., Evelyn Brody, *A Taxing Time for the Bishop Estate: What is the I.R.S. Role in Charity Governance*, 21 U. HAW. L. REV. 537, 537–41 (1999).

82. See Letter from Evelyn Brody, Professor of Law, Chicago-Kent College of Law, to Charles E. Grassley, Chairman, U.S. Senate Comm. on Fin. & Max Baucus, Ranking Member, U.S. Senate Comm. on Fin. 8 (July 15, 2004),

<http://www.urban.org/research/publication/submission-response-june-2004-discussion-draft-senate-finance-committee>; *supra* notes 10, 29 and accompanying text.

83. See *supra* note 34 and accompanying text.

84. See Treas. Reg. § 1.501(c)(3)-1(b)(4) (2014); *supra* note 11 and accompanying text.

85. See *supra* notes 12, 37, 38 and accompanying text.

86. See *supra* note 23 and accompanying text.

divide their functional roles, with states setting the standards for such exemptions, local governments applying those standards (generally through local assessment bodies), and state courts serving as the ultimate forum for resolving disputes between nonprofits and local assessment bodies.<sup>87</sup> It should also be noted that while many states oversee governance, charitable assets, and charitable solicitation in an integrated fashion, usually within the attorney general's office, some states split these responsibilities among multiple state agencies.<sup>88</sup>

Finally, both the states and the federal government have the authority to impose registration, reporting, and related public disclosure requirements on nonprofits in connection with their oversight responsibilities, although the states tend to limit these requirements to nonprofits considered charitable under state law.<sup>89</sup> The states piggyback on the federal government's requirements in this area to some extent in that many states require submission of a nonprofit's Form 990 as part of or even in complete satisfaction of the applicable state reporting requirements.<sup>90</sup> It is in part for this reason that state officials have been involved in past federal efforts to revise that form.<sup>91</sup>

The greatest area of overlap is therefore with respect to governance issues, particularly transactions with governing board members, officers, and other insiders that are subject both to the state law duty of loyalty and the federal prohibition on private inurement (the latter applying to most, although not all, tax-exempt nonprofits). In this area there is both substantive and functional overlap, since the states and the federal government both set and enforce standards in this area.<sup>92</sup> There is a lesser overlap with respect to governance standards relating to the state law duty of care, in that the federal government suggests certain best practices by inquiring about them on the Form 990 but does not actually require any particular practices (except with respect to private foundations).

Other areas of overlap are with respect to tax benefits and information gathering. While the states have independent authority with respect to state tax exemption and state deductibility of charitable contributions, in practice states often rely on federal determinations in

87. See *supra* note 22 and accompanying text.

88. See *supra* note 18 and accompanying text.

89. See *supra* notes 15, 34 and accompanying text.

90. See Fishman, *supra* note 33, at 264–65; Nave, *supra* note 12, at 230, 230 n.14.

91. See *supra* note 42 and accompanying text.

92. This situation is an example of what has come to be known as “dynamic federalism.” See ANTHONY J. BELLIA JR., *FEDERALISM* 216 (2011).



these areas.<sup>93</sup> Similarly, while states have independent authority to require registration and reporting, in practice states often require non-profits to file a copy of their federal Form 990 to satisfy in part or in whole any such state requirements.<sup>94</sup>

The following chart provides a summary of these observations, over-simplified for the sake of brevity:

93. *See supra* notes 13, 16, 77 and accompanying text.

94. *See supra* note 90 and accompanying text.

	<b>States Exclusively</b>	<b>States Dominate</b>	<b>Shared Authority</b>	<b>Federal Dominates</b>	<b>Federal Exclusively</b>
<b>Formation Dissolution</b>	Legal Form Procedures		Non-distribution Constraint/ No Private Inurement	Requirements for Charities	
<b>Governance</b>	Duty of Obedience	Duty of Care (federal role: Form 990 Questions)	Duty of Loyalty/No Private Inurement	Charities (on dissolution) & Private Foundations	
<b>Tax Benefits</b>		State Tax Benefits (some reliance on federal tax benefits)			Federal Tax Benefits
<b>Charitable Solicitation</b>		State Requirements (federal role: FTC)			
<b>Reporting &amp; Disclosure</b>		State Filings (some reliance on federal filings)			Federal Filings

Finally, before considering which of the potential advantages and disadvantages stemming from fragmented oversight actually exist in the nonprofit area, it is necessary to set aside common concerns relating to nonprofit oversight that arise from sources other than fragmentation. One such concern is the long-standing lack of sufficient funding, which exists both at the state and federal levels.<sup>95</sup> Commentators generally attribute this problem to a lack of prioritization by Congress and state legislatures, as opposed to an assumption that the other level will provide sufficient funding and therefore oversight.<sup>96</sup> A related concern is the lack of attention provided by the agencies that primarily house this oversight function, the IRS at the federal level and typically the attorney general's office at the state level.<sup>97</sup> Commentators generally attribute this problem to these agencies having many other responsibilities, as opposed to a belief that the other level will provide sufficient attention.<sup>98</sup> A third concern at the federal level is that nonprofit oversight is often hindered by processes and rules designed for the IRS' primary task of revenue collection but that do not fit well with overseeing nonprofits.<sup>99</sup> This concern arises from the historical fact that the federal oversight role arose from, and still is based in, the provision of tax benefits and so is primarily assigned to the IRS. Finally, a fourth concern is that decisions regarding which nonprofits to investigate and what positions to take during such investigations are often driven by political concerns at both the state and federal levels.<sup>100</sup>

Of course these four concerns may be related to the advantages and disadvantages that arise from the fragmented nature of current

95. See, e.g., Mark S. Blodgett et al., *State Oversight of Nonprofit Governance: Confronting the Challenge of Mission Adherence Within a Multi-Dimensional Standard*, 32 J.L. & COM. 81, 89–92 (2013); Brody, *supra* note 17, at 951; Helge, *supra* note 26, at 20–23; Jenkins, *supra* note 9, at 1128–30.

96. See, e.g., FREMONT-SMITH, *supra* note 4, at 363, 444–46; Blodgett et al., *supra* note 95, at 90–91; Jenkins, *supra* note 9, at 1130.

97. See, e.g., Blodgett et al., *supra* note 95, at 91; Helge, *supra* note 26, at 24–25; Jenkins, *supra* note 9, at 1130.

98. See, e.g., Blasko et al., *supra* note 7, at 38–39; Blodgett et al., *supra* note 95, at 91; Fishman, *supra* note 33, at 262–63; Helge, *supra* note 26, at 24–25; Jenkins, *supra* note 9, at 1130. Norm Silber identified a couple contrary examples but later noted that they may actually have reflected an appropriate recognition that deference was due to the other agency. See Silber, *supra* note 10, at 613–18, 636.

99. See, e.g., Helge, *supra* note 26, at 25–26; Marcus S. Owens, *Charity Oversight: An Alternative Approach*, COLUM. UNIV. ACAD. COMMONS 5 (2013), <http://academiccommons.columbia.edu/catalog/ac%3A168628>.

100. See, e.g., FREMONT-SMITH, *supra* note 4, at 446–47; Brody, *supra* note 4, at 249; Helge, *supra* note 26, at 27–31.

nonprofit oversight. They may also impact the magnitude of those advantages and disadvantages, as will be discussed in this Part. But it does not appear that these concerns, as significant as they are, stem primarily from that fragmentation.

## 2. Resulting Advantages and Disadvantages

As detailed in Part II.A above, with respect to the effectiveness of oversight in a given area, fragmentation can improve effectiveness in a number of ways, including through a reduced chance of missing important issues or instances of noncompliance, a reduced chance of agency capture, and increased experimentation.<sup>101</sup> Conversely, it can decrease effectiveness in a number of ways, including through an increased chance of missing important issues or instances of noncompliance (for example, because one regulator incorrectly assumes that the other regulator is picking up the slack), races to the bottom, crowding out, inconsistent regulatory demands, and a lack of uniformity.<sup>102</sup>

In the nonprofit context, the presence of at least two primary regulators (the IRS and, in each state, the attorney general) with partially but not completely overlapping responsibilities appears to have had the positive effect of making it less likely that important issues and instances of noncompliance are missed.<sup>103</sup> This result is likely attributable to the fact that both regulators are well aware of the resource constraints faced by the other and so are unlikely to assume that the other has the waterfront covered, a conclusion that is reinforced by the fact that each has areas that are its exclusive responsibility. In addition, the primary area of overlap—violations of the state duty of loyalty and the federal private inurement prohibition—is an area of particular concern to the public and so neither regulator is likely to seek to try to shift responsibility for that area to the other.<sup>104</sup> Furthermore, if the vulnerability of the state attorneys general to election-related political pressures might lead them to under enforce in a given instance of apparent noncompliance (a form of capture), the relative political insulation of the IRS could leave it free to still operate.<sup>105</sup> For example, in the Bishop Estate case in Hawaii the appointed state attorney general lost her posi-

101. See *supra* notes 56–58 and accompanying text.

102. See *supra* notes 65–68 and accompanying text.

103. See Helge, *supra* note 26, at 21–23; but see Silber, *supra* note 10, at 636–37 (raising concerns about the developing overlap in the loyalty/inurement area).

104. See Camacho & Glicksman, *supra* note 48, at 52; Reiser, *supra* note 12, at 225–26, 240.

105. See, e.g., Brody, *supra* note 17, at 949–50 (attributing two instances of state attorney general inaction to possible deference to the leaders of the nonprofit at issue).

tion in part because of the political blowback from her pursuit of the estate's trustees, but the IRS was able to continue pursuing its enforcement action.<sup>106</sup> Finally, the IRS may be more inclined to favor a rules approach to enforcing legal standards (for example, by requiring specific governance practices) so as to reduce costs and avoid controversy while state attorneys general may be more inclined to favor a principles approach to such enforcement given their greater political sensitivity, which would also tend to reduce the likelihood that important instances of noncompliance would be missed.<sup>107</sup>

The other major potential advantage of fragmentation related to effective oversight—experimentation—is not particularly evident in this context, perhaps because the level of activity at both the state and federal levels is relatively low.<sup>108</sup> While the IRS has taken some innovative steps to improve oversight, particularly recently, it does not appear that it was motivated by any sense of competition with state authorities.<sup>109</sup> At the same time, most of the major potential disadvantages of fragmentation also appear to be lacking—there is little evidence of a race to the bottom, or of crowding out by either the federal government or the largest states.<sup>110</sup> Similarly, in the areas of overlap there appears to be relative consistency either because the states and the federal government have generally converged on the same standard (with respect to the loyalty/inurement area) or because one has deferred to the other (*e.g.*, many states to the federal government with respect to the requirements for certain tax benefits).<sup>111</sup> While there are some exceptions—states sometimes have different or additional requirements for state tax benefits, beyond what is required for federal tax benefits, and the federal government imposes more

106. See SAMUEL P. KING & RANDALL W. ROTH, *BROKEN TRUST: GREED, MISMANAGEMENT & POLITICAL MANIPULATION AT AMERICA'S LARGEST CHARITABLE TRUST* 256–57 (2006); Brody, *supra* note 81, at 538–39.

107. See generally James J. Park, *Rules, Principles, and the Competition to Enforce the Securities Laws*, 100 CAL. L. REV. 115 (2012) (comparing the Securities and Exchange Commission to federal prosecutors and state attorneys general).

108. See Jenkins, *supra* note 9, at 1175.

109. See I.R.S., *TE/GE PRIORITIES FOR FY 2016* 7 (2015), [http://www.irs.gov/pub/irs-tege/TEGE\\_Priorities\\_for\\_FY2016.pdf](http://www.irs.gov/pub/irs-tege/TEGE_Priorities_for_FY2016.pdf) (new compliance strategy); I.R.S., *TE/GE PROGRAM LETTER FY 2015* 2 (2014), [https://www.irs.gov/pub/irs-tege/tege\\_fy15\\_program\\_letter.pdf](https://www.irs.gov/pub/irs-tege/tege_fy15_program_letter.pdf) (development of new Form 1023-EZ).

110. See Jenkins, *supra* note 9, at 1161–65.

111. See Letter from Evelyn Brody to Charles E Grassley and Max Baucus, *supra* note 82, at 8; but see Fishman, *supra* note 27, at 579 (concluding that intermediate sanctions implicitly preempted the state duty of loyalty with respect to financial transactions with insiders).

stringent governance-related limitations on private foundations<sup>112</sup>—even these variations tend to only add to the limitations on the affected nonprofits, not to create contradictory requirements. For example, a nonprofit hospital that satisfies the requirements for federal tax exemption and receipt of federally deductible charitable contributions may face additional requirements to obtain state tax exemptions, but those additional requirements do not contradict the federal requirements for tax exemption.<sup>113</sup> The one significant exception is the decision by the IRS to begin suggesting specific best practices relating to governance that go beyond what is required by state law and that may be imprudent under the state duty of care for some nonprofits.<sup>114</sup>

With respect to the efficiency of oversight, fragmentation can improve efficiency if it leads to greater development of expertise and relevant information and an allocation of responsibilities that takes advantage of the differences between the agencies involved. Conversely, efficiency can suffer if fragmentation results in duplication of efforts, if it undermines the realization of potential economies of scale, or if it results in high coordination costs.

In the nonprofit context, fragmentation does not appear to have led to the development of significantly more expertise as compared to if there was only a single regulator, if only because the states have devoted few resources to developing such expertise.<sup>115</sup> As for the development of relevant information, that development has been hindered by limited information sharing between the states presumably because of limited resources (although this may have improved somewhat in recent years) and by the inability of the IRS to easily share information with state authorities because of taxpayer privacy laws.<sup>116</sup> It is less clear whether the current allocation of responsibilities takes advantage of the relative differences between state attorneys general and the IRS, including the political/nonpolitical distinction and the presumably

112. See Fremont-Smith, *supra* note 32, at 636–38.

113. See Kathryn J. Jervis, *A Review of State Legislation and a State Legislator Survey Related to Not-for-Profit Hospital Tax Exemption and Health Care for the Indigent*, 32 J. HEALTHCARE FIN. 36, 50–61 (2005).

114. See BRIER ET AL., *supra* note 27, at 2–4.

115. See Jenkins, *supra* note 9, at 1129–30; but see *About the Charities Regulation and Oversight Project*, COLUM. LAW SCH., <http://web.law.columbia.edu/attorneys-general/policy-areas/charities-law-project/about-charities-regulation-and-oversight-project-0> (last visited Jan. 15, 2016) (initiative to develop this expertise).

116. See CARRIKER ET AL., *supra* note 42, at 34–37; Owens, *supra* note 99, at 6–7; Letter from NASCO to Max Baucus, Chairman, U.S. Senate Comm. on Fin. & Orrin Hatch, Ranking Member, U.S. Senate Comm. on Fin. (Oct. 28, 2011), <http://www.nasconet.org/fedstate-information-sharing-letter/naag-info-share-letter/>.

greater local knowledge and focus of the attorneys general. The current allocation does, however, take advantage of the national scale of the IRS to centralize certain functions that benefit from economies of scale, including the processing of applications of recognition of exemption and of Forms 990, although the IRS has somewhat undermined this advantage recently through the introduction of streamlined application processes.<sup>117</sup>

As for disadvantages, there is little if any evidence of duplication of efforts except in two areas. While the states have the ability to enforce a number of federal tax provisions that affected nonprofits are required to include in their governing documents, they appear not to have taken much advantage of this authority.<sup>118</sup> In several areas, many if not most states have in fact taken advantage of federal standards and processes to reduce duplication, such as with respect to requirements for tax benefits and gathering of information.<sup>119</sup> There is the potential for duplication with respect to areas of overlap, particular in the loyalty/inurement area, but this appears to have occurred only rarely, perhaps because of resource constraints and the different time tables for enforcement (state attorneys general can open an investigation at any time, while the IRS generally has to wait for the filing of a Form 990 for the relevant period).<sup>120</sup>

One area of potentially significant overlap, however, is with respect to the duty of care. The IRS has begun to make significant inroads into this area, and there have been congressional proposals that would empower it to go even further.<sup>121</sup> The problem with these proposals is that they risk subjecting tax-exempt nonprofits to unnecessarily burdensome requirements that greatly exceed the demands of the state

117. See Letter from Alissa Hecht Gardenswartz, President, NASCO, to Office of Info. & Regulatory Affairs (Apr. 30, 2014), <http://www.nasconet.org/wp-content/uploads/2014/05/FINAL-NASCO-comments-re-Form-1023-EZ1.pdf> [hereinafter NASCO 2014 Letter].

118. For a recent example of such state attorney general enforcement, see *Parks v. Comm'r*, 145 T.C. 12, 11 (2015) (describing Oregon attorney general audit and lawsuit of a private foundation relating to alleged violations of federal tax law).

119. See *supra* notes 16, 90 and accompanying text.

120. See Owens, *supra* note 99, at 6. For enforcement conflict example, see Francie Latour & Walter V. Robinson, *Trustees to Reimburse Charitable Foundation*, BOSTON GLOBE, Apr. 14, 2006, at B1 (former trustee of a private foundation unable to fully repay amounts owed to the foundation under an agreement with the state attorney general, in part because the IRS seized part of the trustee's available funds in satisfaction of excise taxes owed on excessive compensation received by the trustee).

121. See BRIER ET AL., *supra* note 27, at 8, 10.

duty of care and in fact may be imprudent for smaller charities with limited resources.<sup>122</sup>

The other area of potentially significant overlap, at least for charities, is between the various states (and between the states and local governments) with respect to charitable solicitation requirements. While the regulatory goals of the various states are presumably the same—protection of their residents from fraudulent or deceptive fundraising—the numerous registration and reporting requirements for charities that solicit contributions in multiple jurisdictions is duplicative and a significant burden on both the states and nonprofits.<sup>123</sup> The same could be said of the overlap between states and local jurisdictions that impose their own charitable solicitation requirements.

Finally, there is some evidence that fragmentation does in fact reduce the costs of monitoring by the public and political overseers with respect to at least the IRS. More specifically, NASCO has shown itself willing to not only provide behind-the-scenes advice to the IRS but to also publicly criticize IRS actions if NASCO members deem them detrimental to the oversight of nonprofits.<sup>124</sup> At the same time, there appear to be few attempts by either attorneys general or the IRS to shift the blame for an oversight failure to the other party, perhaps in part because of the limited overlap between their responsibilities and in part because the area of greatest overlap—loyalty/inurement—is of too great concern to the public to permit easy avoidance of responsibility.

\* \* \*

This analysis indicates that for the most part the current allocation of responsibilities between the states and the federal government, including the limited areas of overlap, results in relatively effective oversight given the resource and other constraints under which both levels operate, with the possible exceptions of the federal government's decision to begin suggesting best practices relating to governance, an area historically overseen by the states, and the overlapping

122. See, e.g., *id.* at 42–45; but see Ellen P. Aprill, *What Critiques of Sarbanes-Oxley Can Teach About Regulation of Nonprofit Governance*, 76 *FORDHAM L. REV.* 765, 793–94 (2007) (supporting minimal federal governance standards).

123. See Daniel Moore, *On Accountability: A State Charity Official's Prospective*, 2001 *PHILANTHROPIC FUNDRAISING* 103, 106–07; Nave, *supra* note 12, at 232–33.

124. See NASCO 2014 Letter, *supra* note 117; Letter from Hugh R. Jones, President, NASCO, to Lois Lerner, Dir., I.R.S. Exempt Organizations Division (Dec. 17, 2007), [http://web.law.columbia.edu/sites/default/files/microsites/attorneys-general/Hugh%20Jones%20DOC019\\_0.pdf](http://web.law.columbia.edu/sites/default/files/microsites/attorneys-general/Hugh%20Jones%20DOC019_0.pdf) [hereinafter NASCO 2007 letter].



jurisdiction of the states (and some local governments) with respect to charitable solicitation. At the same time, there are indications that this allocation results in some unnecessary inefficiencies, particularly as a result of the limitations on the ability of the IRS to effectively share information with state attorneys general. There also are indications that the IRS has to be careful about reducing its role in areas where the states rely on IRS activity so as not to create regulatory gaps at both the federal and state levels, with the IRS decision to streamline the application for recognition of exemption process being the prime example. These conclusions indicate that while in general the current fragmented oversight of nonprofits likely works better than other possible allocations of oversight authority, there is room for improvement. The next Part will therefore recommend possible changes.

### III. RECOMMENDATIONS

Once the significant disadvantages arising from fragmented oversight are identified, there are three possible ways to reduce or eliminate them.<sup>125</sup> The first and most obvious is consolidation—eliminating the fragmentation by moving all authority over a particular area to a single government agency. The potential downside of this solution is that it would also eliminate any advantages that may arise from fragmented oversight. The second alternative is retaining the fragmentation but improving coordination in a manner designed to address the identified disadvantages. The third is reallocating existing authority so as to reduce or eliminate overlaps—that is, giving each agency distinct authority and/or a distinct role—although each agency would still exercise some authority in the general area at issue.

Given the limited resources and low prioritization of nonprofit oversight both at the state level and the federal level, and therefore the advantage of having multiple government agencies overseeing nonprofits generally, consolidation is inadvisable if there are other ways of ameliorating the identified disadvantages. Moreover, with respect to the loyalty/inurement overlap it appears that fragmentation brings with it a reduced chance of significant instances of noncompliance being missed, while any disadvantages are minimal or non-existent. Therefore, even if significantly greater resources become available at either level—such as through the creation of a national self-regulatory

125. See Camacho & Glicksman, *supra* note 48, at 23–24; Freeman & Rossi, *supra* note 48, at 1153–55.

body with dedicated funding—it likely would be advisable to retain this overlap.

There are, however, two areas where consolidation may improve efficiency without undermining any existing advantages. One such area is the gathering of relevant information by the IRS, both through the application process and the required annual information returns. As a general matter, consolidation of information gathering—if that information can then be easily shared with all relevant governmental authorities—takes advantage of economies of scale while reducing duplicative burdens on both those authorities and the regulated community.<sup>126</sup> This conclusion therefore supports not only having states continue to rely on the Form 990 as the primary if not exclusive reporting mechanism for charitable solicitation and other purposes, but also having the federal government move as expeditiously as possible toward mandatory e-filing for most if not all Forms 990 to facilitate the sharing and use of the information provided on those forms.<sup>127</sup> It also suggests caution when streamlining the application process or the annual information return, since doing so reduces the information available for not only the federal government but also the states, and may also make the states less comfortable with relying on federal exemption determinations for granting state exemptions and other benefits.<sup>128</sup>

The other area would be with respect to financing oversight not only at the federal level but also at the state level. As a general matter, consolidation of financing helps overcome collective action problems and allows access to the greater financial resources of the federal government.<sup>129</sup> Previously, Brendan Wilson and I suggested this approach with respect to supporting state efforts to oversee governance, and the staff of the Senate Finance Committee has made similar suggestions.<sup>130</sup> If additional resources could be secured at the federal level to support

126. See Mark L. Ascher, *Federalization of the Law of Charity*, 67 VAND. L. REV. 1581, 1606–07 (2014); Camacho & Glicksman, *supra* note 48, at 83–84; Myles McGregor-Lowndes, *Australia – You Put Your Front Foot In and Your Front Foot Out and You Boot It All About!*, 91 CHI.-KENT L. REV. 1021 (2016) (describing benefits to charities from such consolidation by the new Australian Charities and Not-for-profits Commission).

127. See Moore, *supra* note 123, at 115–17.

128. See NASCO 2014 Letter, *supra* note 117; NASCO 2007 Letter, *supra* note 124.

129. See Camacho & Glicksman, *supra* note 48, at 84–85.

130. See STAFF OF THE SENATE FIN. COMM., DISCUSSION DRAFT ON PROPOSED REFORMS FOR EXEMPT ORGANIZATIONS 15 (2004),

<http://www.finance.senate.gov/imo/media/doc/062204stfdis.pdf> [hereinafter DISCUSSION DRAFT]; Mayer & Wilson, *supra* note 1, at 540–41.

such an effort, this approach could help relieve the resource pressures without having to sacrifice the benefits stemming from the existing fragmentation.<sup>131</sup>

What about the current division of charitable solicitation responsibility among the various states (and some local governments)? This division imposes duplicative burdens on both these governments and the regulated community with respect to charities that operate in multiple jurisdictions. At the same time, however, some charities only operate within a single jurisdiction and therefore are more amenable to state or local oversight, so consolidating oversight in this area at the national level is inadvisable. A better approach would therefore be to complete the ongoing efforts to coordinate the registration and reporting obligations by permitting charities to use a single Internet portal and common form for these purposes so as to reduce this duplication without undermining state authority in this area.<sup>132</sup> It would also be advisable to reduce the role of local governments, perhaps granting them access to state registration records but otherwise limiting their role to requiring local registration with respect to door-to-door solicitations and enforcing laws against false, misleading, or deceptive solicitations, as former NASCO President Daniel Moore has suggested.<sup>133</sup>

The other area where coordination, as opposed to consolidation, appears advisable is with respect to enforcement actions, especially those relating to duty of loyalty/private inurement issues over which both the federal government and the states have standard setting and enforcement authority.<sup>134</sup> Both the staff of the Senate Finance Committee and numerous commentators have recommended that ways be found to permit the IRS to more easily share information with state charity overseers.<sup>135</sup> The IRS also might be able to help states coordinate among themselves.<sup>136</sup> In addition, such coordination would limit

131. While securing additional resources at the federal level may seem unlikely, the creation of a national self-regulatory body might resolve this issue. *See* Mayer, *supra* note 2.

132. *See* THE MULTI-STATE FILER PROJECT, *supra* note 15; FREMONT-SMITH, *supra* note 4, at 458-59; Reiser, *supra* note 12, at 237.

133. *See* Moore, *supra* note 123, at 116.

134. *See* CARRIKER ET AL., *supra* note 42, at 36-37.

135. *See* GAO 2014 REPORT, *supra* note 36, at 36-40; DISCUSSION DRAFT, *supra* note 130, at 16; Silber, *supra* note 10, at 630; NASCO 2014 Letter, *supra* note 117; *see generally* NAT'L COMM. ON RESTRUCTURING THE IRS, A VISION FOR A NEW IRS 45 (1997) (recommending more federal-state cooperation generally); Freeman & Rossi, *supra* note 48, at 1146; Marisam, *supra* note 51, at 185.

136. *See* Blodgett et al., *supra* note 95, at 91.

the risk of unnecessary duplication or contradictory demands, although neither issue appears to have been a major concern to date.<sup>137</sup>

Finally, the one area where existing distinct substantive jurisdictions and roles are being eroded but should instead be maintained is with respect to the duty of care, and particularly with respect to standard setting. The moves by the IRS into this area through recommended best practices have attracted significant criticism because they suggest a one-size-fits-all approach that goes well beyond what is required by the state law duty of care, and may even be an imprudent use of the limited resources available to smaller tax-exempt nonprofits.<sup>138</sup> The IRS should therefore go no further in this area, thereby leaving enforcement of the duty of care to the states (outside of the private foundation area), and should also consider withdrawing to some extent, thereby also leaving the standard setting for the duty of care to the states and their greater expertise and their ability to customize standards to the circumstances of particular nonprofits.<sup>139</sup>

#### CONCLUSION

Fragmented oversight of nonprofits among different government agencies raises effectiveness, efficiency, and accountability concerns. Fortunately, the now significant academic literature relating to fragmented oversight provides insights that help identify both the advantages and disadvantages of fragmentation in this context and the best methods for reducing those disadvantages while retaining the advantages. That literature indicates that for the most part fragmented oversight of nonprofits works and so should be maintained, but the federal government and the states could improve their fragmented oversight by recognizing the specific trade-offs of fragmentation and carefully choosing certain areas for consolidation, coordination, or elimination of overlaps.

137. See *supra* note 103 and accompanying text.

138. See *supra* note 114 and accompanying text.

139. See BRIER ET AL., *supra* note 27, at 21, 43–44, 48; Mayer & Wilson, *supra* note 1, at 516–18; Letter from Evelyn Brody to Charles E. Grassley & Max Baucus, *supra* note 82, at 5–6. For a study that suggests that IRS involvement with governance standards may be having a positive effect, see AMY BLACKWOOD ET AL., THE STATE OF NONPROFIT GOVERNANCE (2014), [http://www.urban.org/research/publication/state-nonprofit-governance/view/full\\_report](http://www.urban.org/research/publication/state-nonprofit-governance/view/full_report).

