11-2024

Taxation's Limits

Luís C. Calderón Gómez
Benjamin N. Cardozo School of Law, luis.calderongomez@yu.edu

Recommended Citation
Luís C. Calderón Gómez, *Taxation's Limits*, 119 Nw. U. L. Rev. 571 (2024).
https://larc.cardozo.yu.edu/faculty-articles/925

Printed in U.S.A.
Vol. 119, No. 3

TAXATION'S LIMITS

Luís C. Calderón Gómez

ABSTRACT—Countless pages have been devoted to the question of why everyone should pay tax, yet its opposite has gone largely unnoticed: why should some people and organizations not pay tax? Our tax system exempts from ordinary income taxation a wide and diverse array of people and organizations engaged in significant economic activity—from parents providing childcare services for their family to consular activities and charities operating animal shelters—seemingly without a convincing explanation. Perhaps because of the dizzying diversity of tax-exempt activities, scholars and policymakers have avoided comprehensively or coherently justifying our exemption regimes.

This Article develops a novel normative theory that rationalizes and justifies our current tax exemption regime. Rather than conceiving of exemptions as subsidies or individual deviations from a normative base explainable by ordinary politics, this Article argues that exemptions are best understood as mapping the "limits" of tax. These limits are neither arbitrary nor merely a collection of individual subsidies to favored activities; rather, they are best seen as reflective of deeper collective sociopolitical judgments about the scope of the State and the public sphere.

This Article constructs the "Limits Theory" by explaining and justifying the three most significant exemption regimes: those exempting the nuclear family, other sovereigns, and charities. The nuclear family perhaps occupies the center of the private sphere; its location demands exemption due to its intimate and private—not public—character. Notions of comity and federalism buttress the exception for other sovereigns, cautioning against the taxation of a public sphere by other public spheres. Lastly, charities' unique public–private hybrid character, oriented towards purposes aligned with the public sphere yet operated as private autonomous associations, justifies charities' exclusion from the ordinary limits of taxation—limits that cover ordinary for-profit organizations that strive to both do good and do well. The collective sociopolitical judgments grounding these exemptions are neither novel nor idiosyncratic; in fact, they are traceable to the work of political theorists of all stripes seeking to define the public sphere, from Rawls's liberalism to Nozick's libertarianism and communitarianism à la Walzer or MacIntyre.

In developing a theoretical account, this Article does more than construct a coherent framework for thinking about tax exemptions more generally. Visualizing exemptions as limits rather than subsidies also allows us to explain and justify key common features of the exemptions—for example, the law's insistence that the commercial character of an activity vitiates exemption across different exemption regimes, foreclosing the possibility of for-profit charities and supporting the taxation of commercial enterprises run by other states. But perhaps most importantly, the theory illuminates the direction for further examination and refinement of the law. It renders exemptions intelligible and coherent at a more granular level. It offers a common and normatively rich framework for scholars and policymakers to engage in more fruitful debates about old and new issues regarding the proper scope of current exemption regimes—for example, on whether the PGA Tour and the Saudi sovereign wealth fund deserve to lose their tax exemptions upon completion of their controversial combination.

AUTHOR—Assistant Professor, Cardozo School of Law. For invaluable comments and conversations, I would like to thank Anne Alstott, David Carlson, Jon Endean, Victor Fleischer, Brian Galle, Ari Glogower, Mitchell Kane, Christine Kim, Leandra Lederman, Alma Magaña, Ajay K. Mehrotra, Jeesoo Nam, Jeffrey A. Schoenblum, Anthony J. Sebok, Stew Sterk, Matthew Wansley, Sam Weinstein, Edward Zelinsky, and the participants of the Northwestern Tax Policy Colloquium, the Indiana Tax Policy Colloquium, the Junior Tax Workshop, the Law & Society Association Annual Meeting, the Cardozo Junior Faculty Workshop, and the Boston College Tax Policy Colloquium. I am also grateful to Sophie Winnick for her research assistance and to the members of the *Northwestern University Law Review* for their thoughtful comments and careful editing. All errors are my own.

INTRODUCTION

The news simultaneously commandeered the airtime of sports reporting and political late-night shows for several days, an unusual feat for a corporate transaction. Saudi Arabia's sovereign wealth fund,[1] the Public Investment Fund (PIF), announced that it would enter into a corporate "combination" with the PGA Tour. The agreement shocked both policy types and sports fans, as it portended the Saudi government's takeover of another major sports league. Just a couple of months before, the PIF had essentially acquired the entire e-sports industry,[2] following years of buying professional sports teams and offering nine-figure contracts to professional footballers such as Cristiano Ronaldo, Kylian Mbappé, and Lionel Messi in a bid to raise the profile of the Saudi football league[3] (or "sports-wash" the regime's reputation, according to its critics[4]).

The PGA Tour transaction faced immediate pushback, with critics decrying its "substantial adverse impact on competition."[5] The Saudis had recently launched LIV Golf, a rival to the PGA Tour that hosts golf competitions outside of the United States, and they were mounting a strong offensive against the PGA Tour through splashy player acquisitions and high-stakes litigation. The deal would effectively merge the commercial entities, ending their competition and ensuring that there was only one game

[1] Sovereign wealth funds are "government-owned investment funds established for a variety of purposes" and funded by assets denominated in a foreign currency. *See* STAFF OF JOINT COMM. ON TAX'N, 110TH CONG., JCX-49-08, ECONOMIC AND U.S. INCOME TAX ISSUES RAISED BY SOVEREIGN WEALTH FUND INVESTMENT IN THE UNITED STATES 22 (Comm. Print 2008) [hereinafter JCT SWF REPORT]. Sovereign wealth funds have become quite large and control an increasing share of global assets. As of February 2023, sovereign wealth funds had $11.515 trillion in assets under management, with more than 170 sovereign wealth funds in existence. *See* William L. Megginson, Asif I. Malik & Xin Yue Zhou, *Sovereign Wealth Funds in the Post-Pandemic Era*, J. INT'L BUS. POL'Y, Apr. 12, 2023, at 2. Saudi Arabia's sovereign wealth fund is currently the seventh largest globally, with $620 billion under management. *Id*.

[2] *See* Lewis Gordon, *Saudi Arabia's Plan to Become the Crown Prince of Gaming*, VERGE (Dec. 1, 2023, 11:00 AM), https://www.theverge.com/2023/12/1/23948992/saudi-arabia-gaming-investment [https://perma.cc/VNR6-UH6R].

[3] *See* Ruth Michaelson, *Revealed: Saudi Arabia's $6bn Spend on 'Sportswashing,'* GUARDIAN (July 26, 2023, 12:00 AM), https://www.theguardian.com/world/2023/jul/26/revealed-saudi-arabia-6bn-spend-on-sportswashing [https://perma.cc/TF5R-T3RQ].

[4] *See, e.g.*, Minky Worden, *PGA-Saudi Deal Tees Up Sportswashing*, HUM. RTS. WATCH (June 8, 2023, 2:18 PM), https://www.hrw.org/news/2023/06/08/pga-saudi-deal-tees-sportswashing [https://perma.cc/26JJ-QWBK].

[5] Letter from Elizabeth Warren, Sen., U.S. Senate, and Ron Wyden, Sen., U.S. Senate, to Merrick Garland, Att'y Gen., U.S. Dep't of Just., and Jonathan Kanter, Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Just. (June 13, 2023), https://www.warren.senate.gov/imo/media/doc/2023.06.13%20Letter%20to%20DOJ%20re%20PGA%20LIV%20Deal.pdf [https://perma.cc/EK6L-K97S].

in town.[6] As a result, the Department of Justice indicated it would review the transaction's competitive effects to potentially block the merger.[7] That backlash forced the PGA Tour and PIF to abandon some of the only binding aspects of the announced deal[8]—which is still shrouded in mystery, as the definitive agreement has not been released[9]—and to clarify what the deal would include.[10] While moving slowly, the deal appears to be making some progress.[11] Yet the deal remains in the crosshairs of antitrust authorities.

The competition angle, however, tells only part of the story. Another part of the deal bothered golf fans and players,[12] senators,[13] and sports commentators[14]: the tax exemptions that the PIF and the PGA Tour would continue to enjoy running their combined commercial enterprise.[15] Senator Ron Wyden—Democrats' preeminent tax policymaker and the head of the

---

6 A third entity, the DP Tour, which organizes European tournaments, would also be involved in the new combined commercial entity, titled "PGA Tour Enterprises." *See* Mike Reynolds, *LIV Golf, PGA Tour, DP World Tour Take New Swing as a Combined Commercial Entity*, S&P GLOB. (June 14, 2023), https://www.spglobal.com/marketintelligence/en/news-insights/research/liv-golf-pga-tour-dp-world-tour-take-new-swing-as-a-combined-commercial-entity [https://perma.cc/Q3BQ-LAXL].

7 Andrew Beaton & Louise Radnofsky, *PGA Tour's Deal with LIV's Saudi Backers to Be Investigated by the Justice Department*, WALL ST. J. (June 15, 2023, 7:32 PM), https://www.wsj.com/sports/golf/pga-tour-liv-golf-merger-investigation-antitrust-28d014bf [https://perma.cc/MQ7L-2JDV].

8 *See* Alan Blinder, Lauren Hirsch & Kevin Draper, *Pressured by U.S., PGA Tour and Saudi Fund Drop Key Part of Golf Deal*, N.Y. TIMES (July 13, 2023), https://www.nytimes.com/2023/07/13/sports/golf/pga-tour-liv-saudi-merger-deal.html [https://perma.cc/KLB3-KFMM].

9 The preliminary agreement was leaked to the press, however. *See* Framework Agreement of PGA Tour, Inc., Public Investment Fund of the Kingdom of Saudi Arabia & DP World Tour (May 30, 2023), https://int.nyt.com/data/documenttools/framework-agreement/e6d16d2b509ae1fa/full.pdf [https://perma.cc/A96N-UB26].

10 *The Future of Men's Professional Golf*, PGA TOUR, https://www.pgatour.com/future [https://perma.cc/6GHR-ELDF].

11 Lillian Rizzo & Jessica Golden, *PGA, Saudi-Backed LIV in 'Active Discussions' One Year After Announcing Proposed Deal that Rocked Golf World*, NBC NEWS (June 6, 2024, 2:09 PM), https://www.nbcnews.com/news/sports/pga-live-active-discussions-rcna155892 [https://perma.cc/97JQ-ALHF].

12 *See, e.g.*, Mark Schlabach, *PGA Tour, LIV Golf, DP World Tour Unify 'Under One Umbrella*,*'* ESPN (June 6, 2023, 10:15 AM), https://www.espn.com/golf/story/_/id/37805785/pga-tour-liv-golf-dp-world-tour-announce-merger [https://perma.cc/PUY9-V9DE].

13 *See, e.g.*, Letter from Elizabeth Warren and Ron Wyden to Merrick Garland and Jonathan Kanter, *supra* note 5.

14 Molly Hensley-Clancy & Rick Maese, *The PGA Is a Nonprofit. With Saudi Money, Should It Be?*, WASH. POST (June 22, 2023, 9:23 AM), https://www.washingtonpost.com/sports/2023/06/22/pga-tour-nonprofit-saudi-liv/ [https://perma.cc/3EN8-3TYM].

15 *See, e.g.*, *The PGA–LIV Deal: Implications for the Future of Golf and Saudi Arabia's Influence in the United States: Hearing Before the Subcomm. on Investigations of the S. Comm. on Homeland Sec. & Governmental Affairs*, 118th Cong. 57 app. (2023) (statement of Ron Price, Chief Operating Officer, PGA Tour, Inc.) ("The Tour fully intends to continue to meet the applicable requirements and remain a 501(c)(6) tax-exempt membership organization, regardless of the outcome of the discussions with PIF regarding a potential further agreement, and it is fully committed to continuing in its charitable tradition of donating the net proceeds of the tournaments to charity.").

Senate Finance Committee, who has spearheaded the opposition to the deal in the Senate—succinctly summarized his objections: "It's widely understood that the Saudis rip Americans off at the pump and funnel their oil profits into various efforts to launder the reputation of their violent authoritarian regime, but at a minimum there's no good reason to help them along with a taxpayer subsidy."[16] After the deal's announcement, Wyden sent official letters to the parties requesting more information, held hearings about the deal, and proposed two bills in Congress aimed at stripping both parties of their tax exemption.[17]

The calls to end PIF's and the PGA Tour's tax exemptions appear popular, enjoying seemingly favorable press coverage[18] and potential bipartisan support.[19] However, two crucial points about stripping the exemption remain unarticulated: Why are these two parties worthy of a tax exemption in the first place? And, relatedly, why exactly does the transaction change their worthiness for the exemption?

Wyden has offered a plethora of different rationales for stripping out the organizations' exemptions. At times, Wyden has questioned whether "organizations that tie themselves to an authoritarian regime that has continually undermined the rule of law should continue to enjoy tax-exempt status," suggesting that the organizations' contravention of the "rule of law" annuls the justification for the exemption.[20] At other times, his concern seemed to be whether there were "compensation arrangements, formal or informal, proposed as part of the merger framework" that would vitiate the PGA Tour's charitable status—a concern underscored by the fact that PGA

---

[16] *See* Press Release, U.S. Senate Comm. on Fin., Wyden Launches Investigation of PGA-Saudi PIF Deal, Announces Plan to Revoke Saudi PIF's Special Tax Treatment (June 15, 2023), https://www.finance.senate.gov/chairmans-news/wyden-launches-investigation-of-pga-saudi-pif-deal-announces-plan-to-revoke-saudi-pifs-special-tax-treatment [https://perma.cc/5U3Z-5BZV].

[17] Press Release, U.S. Senate Comm. on Fin., Wyden Introduces Bills Revoking PGA Tour's Tax Exemption, Saudi Public Investment Fund's Special Tax Break (July 26, 2023), https://www.finance.senate.gov/chairmans-news/wyden-introduces-bills-revoking-pga-tours-tax-exemption-saudi-public-investment-funds-special-tax-break [https://perma.cc/VB9Y-GBPH].

[18] *See* Ben Steverman, *Why the PGA Tour's Nonprofit Status Is in Focus with LIV Merger*, BLOOMBERG (June 13, 2023), https://www.bloomberg.com/news/articles/2023-06-13/why-pga-s-nonprofit-status-is-an-issue-in-liv-merger#xj4y7vzkg [https://perma.cc/V3XL-LBWV].

[19] There has been some bipartisan support for such bills in the past. Iowa Senator Joni Ernst, a Republican, and Maine Senator Angus King, an independent, cosponsored a bill that targeted the PGA Tour and would have curtailed the exemption for professional sports leagues organized as § 501(c)(6) organizations. *See* Properly Reducing Overexemptions for Sports Act, S. 1121, 116th Cong. § 4 (2019) (eliminating the exemption for professional sports' § 501(c)(6) organizations and inserting a provision that would exempt them under § 501(c)(3) if they had annual gross receipts of less than $10 million).

[20] *See* Letter from Ron Wyden, Chairman, U.S. Senate Comm. on Fin., to Jay Monahan IV, Comm'r, PGA Tour, and Ed Erlihy, Chairman, PGA Tour (Jun. 15, 2023), https://www.finance.senate.gov/imo/media/doc/letter_to_pga_tour_61523.pdf [https://perma.cc/C224-GKK6].

Tour executives were "already lavishly[ ]compensated."[21] Wyden and the organizations' critics also repeatedly emphasized both entities' size, noting that the PGA Tour has "assets exceeding $500 million" and that PIF has "more than $100 billion invested globally."[22] Lastly, at times, Wyden's focus seemed to be the perceived purpose of the transaction: "betray[ing]" the PGA Tour's charitable mission and "becom[ing] a profit generator for Saudi Arabia's brutal regime," thus "disqualif[ying] itself for a tax exemption."[23] Although these reasons are politically potent and perhaps even intuitively persuasive, there seems to be no consensus on *why* these characteristics are disqualifying—precisely because there is no consensus on why we have tax exemptions in the first place.

Despite some attention given to the charitable[24] tax exemption[25] and the economic magnitude and overall importance of the tax-exempt sector in the U.S. economy,[26] there is no widely accepted "unifying theme or singular principle that explains tax exemption for the many diverse organizations in the exempt sector."[27] But, as the PIF–PGA Tour transaction evidences, policy debates regarding exemptions are far from settled—with continuing disputes ranging from whether we should have for-profit charities to whether we should tax the market value of (predominantly women's) household work. These policy discussions are often confusing and frequently hinge on an underlying yet unspoken critical assumption: the rationale behind such tax exemptions. By developing a theory of tax exemptions, this Article aims to fill that void in the scholarship and, in doing so, aid in resolving these policy debates.

This Article theorizes that the limits of tax are best understood as corresponding to larger sociopolitical judgments about the scope of the public sphere and the effects of subjecting persons and activities to taxation. In other words, the exemptions are neither individual tax policy decisions nor subsidies; they are consequences of widely held societal

---

21 *Id.* at 2.

22 *See* Press Release, U.S. Senate Comm. on Fin., *supra* note 16.

23 *See id.*

24 In this Article, I will use the term "charity" and "charitable" to refer to organizations qualifying for exemption under § 501(c)(3), including religious organizations, as used both colloquially and in the tax policy literature. *See, e.g.*, STAFF OF JOINT COMM. ON TAX'N, 109TH CONG., JCX-29-05, HISTORICAL DEVELOPMENT AND PRESENT LAW OF THE FEDERAL EXEMPTION FOR CHARITIES AND OTHER TAX-EXEMPT ORGANIZATIONS 18 n.3 (2005) [hereinafter JCT CHARITIES REPORT].

25 *See infra* Section III.C.

26 The charitable sector alone constitutes around 5.4% of the U.S. gross domestic product, considerably larger than the defense sector. *See Statistics on U.S. Generosity*, PHILANTHROPY ROUNDTABLE, https://www.philanthropyroundtable.org/almanac/statistics-on-u-s-generosity/ [https://perma.cc/5WF9-56RZ].

27 *See* JCT CHARITIES REPORT, *supra* note 24, at 8.

and political beliefs about the limits of the State and the public sphere. These beliefs reveal themselves in the way that our current tax system has generally granted exemptions to (i) the family, out of social and political concerns regarding the expansion of the State into paradigmatically private relationships; (ii) other sovereigns, out of political considerations of comity; and (iii) charities, out of a concern that their inclusion within the public sphere (or the market) would transform or interfere with their unique character as hybrid organizations that operate privately and autonomously for the public benefit. Consequently, exemptions are best understood as reflecting more general judgments, which are widely held, about who or what should be outside of the public sphere: (i) activities that are part of another public sphere, (ii) activities that are part of a private sphere, and (iii) unique activities that are of a "hybrid" character and for which inclusion in the public sphere would in some important sense devalue them.

This Article analyzes three representative exemptions—the family, other sovereigns, and charities—comprising the vast majority of exempt entities by number, size, and resources.[28] Moreover, they together represent

[28] The charitable exemption is the most significant exemption awarded to any private entity in the Internal Revenue Code (the Code). Around 66% of tax-exempt organizations of this kind are § 501(c)(3) charitable organizations, with this share steadily increasing. *See id.* at 19 (calculating the share as a percentage of total tax-exempt organizations in 2004). The Joint Committee on Taxation (JCT) notes that "[c]haritable organizations also constitute a disproportionately large part of the exempt sector in terms of asset size and revenues." *Id.* at 20. The exemption for "other sovereigns" (e.g., foreign governments, subnational governments, and international organizations) covers, by definition, the vast array of exemptions awarded to public entities in the Code. Finally, the exemption for the family covers the largest exemption for "imputed income" provided by the tax system. The other commonly discussed "imputed income" exemption—the exemption for owner-occupied housing income—is smaller than the imputed income from housework but remains sizeable. *See, e.g.*, Gus Wezerek & Kristen R. Ghodsee, *Women's Unpaid Labor Is Worth $10,900,000,000,000*, N.Y. TIMES (Mar. 5, 2020), https://www.nyt.com/interactive/2020/03/04/opinion/women-unpaid-labor.html [https://perma.cc/9YU6-7XUH] (estimating the value of uncompensated housework at $1.5 trillion for the year 2017); *see also* Benjamin Bridgman, Andrew Craig & Danit Kanal, *Accounting for Household Production in the National Accounts: An Update 1965–2020*, SURV. CURRENT BUS., Feb. 2022, https://apps.bea.gov/scb/issues/2022/02-february/pdf/0222-household-production.pdf [https://perma.cc/RD5G-ZP48] (finding household production increased significantly during 2020). At $1.5 trillion, housework would have three times the economic magnitude of owner-occupied housing. U.S. BUREAU OF ECON. ANALYSIS, TABLE 7.9: RENTAL INCOME OF PERSONS BY LEGAL FORM OF ORGANIZATION AND BY TYPE OF INCOME (last revised Sept. 29, 2023), https://www.bea.gov/itable/national-gdp-and-personal-income [https://perma.cc/665B-SF6W] (click "Interactive Data Tables"; then choose "SECTION 7 – SUPPLEMENTAL TABLES"; then choose "Table 7.9. Rental Income of Persons by Legal Form of Organization and by Type of Income (A)") (estimating that in 2017, the value of owner-occupied housing for households and nonprofit institutions was $515.4 billion). However, the effects of the exemption for income from owner-occupied housing's broader effects (both as a matter of behavior and equity) are less considerable than the effects of the exemption for imputed income from house labor. More importantly, although outside the scope of this Article, the exemption for income of owner-occupied housing can indeed be explained by the Limits Theory, as it is buttressed by sociopolitical judgments strongly resembling those exempting the family. *See infra* note 29.

the most normatively tinged exemptions, with each exemption invoking significant normative considerations that represent concerns for exemptions not analyzed here. So, for example, while this Article does not explicitly analyze the exemption for the imputed rental income from owner-occupied housing, its discussion of the exemption for imputed income from housework's private valence (and its concomitant exclusion from the public sphere) is illustrative.[29] As a result, this Article develops a theory broadly representative of the tax-exempt landscape, even if some exemptions will undoubtedly fall outside the theory's scope.[30]

In advancing a new comprehensive theory that envisions tax exemptions as consequences of the limits of tax, this Article radically departs from previous academic work and legal materials that tangentially have attempted to explain and justify the tax-exempt regime. This situates the Limits Theory in opposition to unarticulated and unsupported but seemingly omnipresent subsidy theories, which, in a realist and positivist vein, suggest that exemptions are merely the result of individual and independent subsidies for organizations that Congress has determined are engaged in some worthy activity.

---

[29] For example, the normative concerns animating the exemption for imputed income from owner-occupied housing echo those animating the exemption for the imputed income from household labor—regarding one's home as a castle or the situs of the private sphere. *See, e.g.*, Steve R. Johnson, *Don't Tax Imputed Income from Owner-Occupied Houses*, NEWSQUARTERLY, Winter 2013, at 17, 19 (discussing the political unpopularity of the taxation of imputed income from owner-occupied housing in the eyes of ordinary taxpayers); Jan K. Brueckner, *Eliminate the Mortgage Interest Deduction or Tax Imputed Rent? Leveling the Real-Estate Playing Field*, 16 CITYSCAPE 215, 215 (2014) ("Taxing imputed rent involves a measurement problem, because the rent that any particular owner-occupied dwelling would command in the rental market is not observed. However, a number of countries, including Switzerland and the Netherlands, follow this practice, and the United States could implement it . . . . Although feasible, taxing imputed rent would be very unpopular and thus politically problematic.").

[30] One important caveat would be "pooling organizations," such as social clubs and fraternities covered by § 501(c)(8). Despite being officially "exempt" from income taxation under the Code, as Professor Boris Bittker and practitioner George Rahdert argue, these organizations are better conceived as not having "income"; rather, these organizations merely operate as a pooling mechanism for their members' incomes. *See* Boris I. Bittker & George K. Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Taxation*, 85 YALE L.J. 299, 305–06 (1976). Note that, unlike most charitable organizations (e.g., the Red Cross), pooling organizations' members and beneficiaries are the same.

Another important caveat is mislabeled "exemptions," that is, provisions that might be labeled as such but without being exemptions in substance, such as the personal "exemption" (and the related standard deduction). The personal exemption (and the standard deduction) is not an exemption. Rather, as Professor John Brooks convincingly shows, these provisions are better understood as comprising both (i) a zero-rate bracket, intended to bring progressivity to the income tax, and (ii) a deduction meant to be a "rough-justice" estimate of commonly claimed deductions, intended to simplify taxpaying by not requiring taxpayers to submit receipts and other documentation for commonly claimed deductions. *See* John R. Brooks II, *Doing Too Much: The Standard Deduction and the Conflict Between Progressivity and Simplification*, 2 COLUM. J. TAX L. 203, 220 (2011).

Why do we need a *theory* of tax exemptions at all? First and foremost, because more general theories cannot readily explain the existence of tax exemptions. Leading theories on the normative tax base—from Musgravian accounts that suppose broad income taxation by the government[31] to optimal tax accounts that suppose all consumption should be taxed uniformly[32]—suggest that we should have no exemptions. Other theories incorporating political mechanisms would similarly suggest that in the government's quest to increase revenue, it would seek to tax all these forms of income.[33] (Models with less draconian assumptions agree.)[34] Lastly, fundamental intuitions about the nature of law would presume that if legal rules are to be *general* in nature,[35] then everyone should, in principle, be generally obliged to pay taxes.[36] As a result, current general theories have a problem explaining the existence of the significant—yet somewhat anomalous—feature of exemptions in our tax system.

This Article seeks to explain that anomaly by advancing the Limits Theory: a *normative* account of the exemptions granted from the otherwise obligatory civic obligation to contribute to the public through taxation. In other words, it is a theory on the limits of tax. As such, it is distinct from a traditionally descriptive or historical account seeking to explain the origins or existence of tax exemptions. That is not to say that this Article's theory will lack significant descriptive power in explaining the existence and contours of our current law;[37] however, the Limits Theory is not a historical or descriptive account of tax exemption, and it need not be. The main and

---

31 *See, e.g.*, R.A. Musgrave, *In Defense of an Income Concept*, 81 HARV. L. REV. 44, 47–49 (1967).

32 *See* Louis Kaplow, *Optimal Income Taxation and Charitable Giving*, 38 TAX POL'Y & ECON. 123, 135 (2024). Professor Kaplow does note that externalities from charitable giving support preferential treatment to charitable giving, endorsing a subsidy-type justification for the charitable regime.

33 *See generally* GEOFFREY BRENNAN & JAMES M. BUCHANAN, THE POWER TO TAX: ANALYTICAL FOUNDATIONS OF A FISCAL CONSTITUTION (1980) (exploring the question of how citizens would constrain the government's "power to tax"); Randall G. Holcombe, *The Ramsey Rule Reconsidered*, 30 PUB. FIN. REV. 562, 576–77 (2002) (arguing that interest-group dynamics entail that the Ramsey Rule be abandoned in designing a tax system in favor of a relatively uniform and fixed tax regime à la Buchanan).

34 *See, e.g.*, Dwight R. Lee & Arthur Snow, *Political Incentives and Optimal Taxation*, 25 PUB. FIN. REV. 491, 497 (1997).

35 *See* LON L. FULLER, THE MORALITY OF LAW (1964).

36 Ability-to-pay theories counsel assigning differential tax responsibilities; however, they do not imply a departure from a general obligation to contribute through taxpaying. *See generally* Ajay K. Mehrotra, *Envisioning the Modern American Fiscal State: Progressive-Era Economists and the Intellectual Foundations of the U.S. Income Tax*, 52 UCLA L. REV. 1793, 1825–31 (2005) (tracing the intellectual roots of the American ability-to-pay theory and comparing it to the benefits theory).

37 As is often (and justifiably) pointed out, a theory that lacks a significant connection to the practical realities of life is usually of little value. *See, e.g.*, Felix S. Cohen, *Transcendental Nonsense and the Functional Approach*, 35 COLUM. L. REV. 809, 820 (1935).

most influential theory in taxation—the Haig–Simons definition of income[38]—is indeed a normative theory that, despite not being able to fully account for all or even most of the features of our income tax, remains both the cornerstone and guiding star of academic and policy discussions on the income tax.[39] As the Haig–Simons definition evidences, a normative theory can be of great academic and policy significance to the literature, even if it does not purport to make irrefutable or grand historical claims. The Limits Theory is *normative* as it reveals and justifies a critical value-laden linkage—and coherence—between exemptions and sociopolitical judgments regarding the public sphere.[40]

Three main reasons motivate this Article's scope and direction as a normative theory. First, there is a dearth of clear historical evidence on the purpose of tax exemptions in general. This dearth has frustrated theorists who have searched for unitary or linear historical narratives through which to explain tax exemption. Second, a comprehensive *descriptive* theory would quickly devolve into an ad hoc enterprise because, despite the common enactment and statutory structure that some tax exemptions share, singular political economy forces have undoubtedly shaped the contours of particular tax exemptions.[41] Third, a comprehensive theory that could somehow fit all

[38] HENRY C. SIMONS, PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY 50 (1938) ("Personal income may be defined as the sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question."); Robert Murray Haig, *The Concept of Income—Economic and Legal Aspects*, *in* THE FEDERAL INCOME TAX 1, 7 (Robert Murray Haig ed., 1921) (providing the initial definition of income that Simons would later tailor).

[39] Starting with the realization requirement. *See* Boris I. Bittker, *A "Comprehensive Tax Base" as a Goal of Income Tax Reform*, 80 HARV. L. REV. 925, 929, 932 (1967). The lack of a realization requirement in the definition of income was, of course, no oversight. SIMONS, *supra* note 38, at 80.

[40] A small discussion of my use of the term "normative" is due. The theory can be partly seen as an explanatory theory of exemptions, rationalizing the law by reference to broader intuitions about the scope of the public sphere and taxation. The theory is not only explanatory, however: the theory is *normative* insofar as it not only explains the law, but it further argues that the law *should* cohere with the sociopolitical intuitions that undergird it. *See infra* note 46 (discussing Dworkin's process of legal purification).

Justifying coherence is not the same as justifying stasis: The Limits Theory does not render the existing limits (or the existing sociopolitical judgments undergirding them) as given, immutable, or just. In fact, this Article suggests ways in which, for example, the taxation of imputed income of household labor could be reformed to alleviate the significant efficiency and distributional (including gender and race) effects of the exemption, by finding ways to change the sociopolitical judgments that undergird the exemption. Therefore, this Article is "normative" in the sense that it explains the current exemption by reference to the sociopolitical judgments that underlie it and advocates for the law's coherence with those judgments; it is not "normative" insofar as that would mean justifying the current limits as given or just. *See infra* note 50.

[41] *See, e.g.*, JOHN D. COLOMBO & MARK A. HALL, THE CHARITABLE TAX EXEMPTION 5 (1995) ("In summary, the charitable exemption arose in earlier centuries as a consequence of the prevailing patterns

of the historical and legal particularities of tax exemptions into its "model" faces a high risk of overfitting, taking as given a system decried as inefficient,[42] too easily abused,[43] too generous,[44] or not generous enough.[45] A normative theory—rather than a positive one—is therefore necessary due to the nature of the stakes involved and the available evidence.

This Article aims to develop a compelling normative theory through a process akin to a reflective equilibrium.[46] It first takes as a given the

of taxation. Classic charities such as churches were not taxed because they did not fit within the existing tax bases, not out of any sense of explicit social policy justification. As the structure of taxing systems evolved, however, the categories of non-taxed activities were retained, despite the change in rationale. As a consequence, we are left with a pattern of exemption defined largely by history and accident.").

[42] *See, e.g.*, DAVID M. SCHIZER, HOW TO SAVE THE WORLD IN SIX (NOT SO EASY) STEPS: BRINGING OUT THE BEST IN NONPROFITS (2023).

[43] *See, e.g.*, DANA BRAKMAN REISER & STEVEN A. DEAN, FOR-PROFIT PHILANTHROPY 12 (2023).

[44] *See, e.g.*, ROB REICH, JUST GIVING: WHY PHILANTHROPY IS FAILING DEMOCRACY AND HOW IT CAN DO BETTER 7 (2018).

[45] *See, e.g.*, Ralph Chami & Connel Fullenkamp, *Should Subsidized Private Transfers Replace Government Social Insurance?* 18–19 (Int'l Monetary Fund, Working Paper No. WP/00/150, 2000), https://www.imf.org/external/pubs/ft/wp/2000/wp00150.pdf [https://perma.cc/23PX-XL7B].

[46] *See* JOHN RAWLS, A THEORY OF JUSTICE 18 (rev. ed. 1999) ("In searching for the most favored description of this situation we work from both ends. We begin by describing it so that it represents generally shared and preferably weak conditions. We then see if these conditions are strong enough to yield a significant set of principles. If not, we look for further premises equally reasonable. But if so, and these principles match our considered convictions of justice, then so far well and good. But presumably there will be discrepancies. In this case we have a choice. We can either modify the account of the initial situation or we can revise our existing judgments, for even the judgments we take provisionally as fixed points are liable to revision. By going back and forth, sometimes altering the conditions of the contractual circumstances, at others withdrawing our judgments and conforming them to principle, I assume that eventually we shall find a description of the initial situation that both expresses reasonable conditions and yields principles which match our considered judgments duly pruned and adjusted. This state of affairs I refer to as reflective equilibrium.").

Some might skeptically worry that this Article takes it as a "given that the actual rules in force [are] implications of the more abstract premises as a whole." Moreover, "[o]ne could induce the premises from the data of the rules, and then deduce correct rules for new situations from the premises established." Duncan Kennedy, *The Role of Law in Economic Thought: Essays on the Fetishism of Commodities*, 34 AM. U. L. REV. 939, 955 (1985). To Professor Kennedy, such reasoning appears circular and might not justify the principles induced—if such principles could be properly induced.

Yet such a concern is misplaced.

First, this Article is not unique in its methodology. This is a well-trodden path for accounts that seek to provide justificatory theories for a body of law. *See, e.g.*, ERNEST J. WEINRIB, THE IDEA OF PRIVATE LAW 16 (rev. ed. 2012).

Perhaps more importantly, there is no naïveté in seeking to make the law "more pure." *See* RONALD DWORKIN, LAW'S EMPIRE 400–01 (1986). As Dworkin notes, seeking to purify (or make the law more coherent)—even from a judge's perspective—requires acknowledging that the law might not be substantively "pure," yielding to considerations of fairness and due process. *Id.* at 407. That being said, finding this pure state is important and not naive. Without it, there is no North Star for legal "purification." Dworkin concludes: "So there is practical importance in isolating the question of what integrity both permits and requires seen from the standpoint of justice alone. For that question marks an significant and structural legal features of our current tax exemptions. With those significant structural features in mind, this Article develops a more abstract theoretical account that can rationalize and justify those legal features. Until now, those features have not been comprehensively and convincingly justified—such as why we tax a charity's commercial endeavors, even if all the endeavors' profits are reinvested in the charity, or why we seem to provide generous tax treatment to the activities of foreign governments. That justificatory theory should deliver better-framed and enriched policy debates. For example, the theory allows us to evaluate particular policy decisions in light of such policy's coherence and fit with the law's larger structure and the sociopolitical judgments buttressing such structure. Furthermore, as we will see, the Limits Theory's explicit linkage of tax exemptions to broader decisions about the scope of the public sphere builds a currently missing bridge between these discrete policy decisions—about which people seem to have seemingly unexplained yet deeply held intuitive concerns—and other well-developed neighboring normative literature, such as the literature on fiscal citizenship and why people pay taxes, the moral limits of the market, and the public sphere—literature that explains and contextualizes such concerns.

This Article's reflective equilibrium methodology, although ensuring that the theory is grounded in the particularities of our law, does constrain the scope of the theory. Given that this Article's theory is abstracted from the structural features of the law of tax exemptions, the theory should reflect the *particular* common or recurring normative concerns behind the law of tax exemptions, if any. The theory need not, however, reflect the purposes or considerations that might go into regulating such tax-exempt entities from other legal or regulatory perspectives. In other words, the theory should give a convincing account of why nonprofit schools are tax-exempt in light of their taxpaying relationship with the State. The theory will not, however, provide us with a full picture of how these same schools interact with the State through education policy, for example, as this particular regulatory regime will likely embody particular (and perhaps even contradictory)

agenda for the community as a whole, as prior to and shaping further questions about what institutional decisions would be necessary to achieve this." *Id.* at 406.

Lastly, unlike the theorists Kennedy criticizes, this Article does not make a strong claim as to the propriety of those abstract induced principles (or in our case, the sociopolitical judgments). *See supra* note 40. Rather, this Article unearths the relationship between these principles and the law of exemptions. This allows us to "bring down" those principles by seeking to rationalize the law and make it more coherent with such principles. Critically, however, it also allows us to "bring up" the law, seeking to address (and hopefully change) the sociopolitical judgments and principles that undergird certain legal rules as a means to effectively advance legal reform.

normative impulses and considerations.[47] Notwithstanding this account's grounding within the domains of tax, its conclusions should still suggest or generate explanations as to how other regimes construe and interact with tax-exempt entities—especially when those other legal regimes reflect similar (or at least compatible) normative considerations.

Furthermore, the theory's scope is limited to tax *exemptions*—it does not cover all deductions, credits, or tax expenditures found in the Internal Revenue Code (the Code). Although functionally similar[48] (but not equivalent[49]) to deductions or credits, exemptions have a symbolic and expressive value that differentiates them from other tax expenditures.[50]

[47] That different bodies of law embody or at least partly reflect different purposes is neither surprising nor a backdoor to a strong "tax exceptionalism." Private and public law scholars frequently state this assumption uncontroversially in distinguishing their legal hemispheres. *See, e.g.*, WEINRIB, *supra* note 46, at 8.

[48] Law and economics scholars and tax academics have long debated the *functional* equivalence of different forms of tax expenditures and have even sought to compare them to regulation. *See, e.g.*, Louis Kaplow & Steven Shavell, *Why the Legal System Is Less Efficient than the Income Tax in Redistributing Income*, 23 J. LEGAL STUD. 667 (1994) (arguing that redistribution of wealth can generally be accomplished more efficiently through the income tax system than through the use of legal rules); Daniel N. Shaviro, *Welfare, Cash Grants, and Marginal Rates*, 59 SMU L. REV. 835 (2006). However, tax scholars such as Professor Leandra Lederman have pointed out that the assumed functional similarity of exclusions and deductions, for example, is truer in theory than in practice. *See* Leandra Lederman, *Statutory Speed Bumps: The Roles Third Parties Play in Tax Compliance*, 60 STAN. L. REV. 695, 704–07 (2007). The practical differences between an exemption and an inclusion with a corresponding deduction do not merely implicate prosaic concerns. As Professor Edward Zelinsky points out, for example, substituting the exemption of some income for churches with a functionally equivalent income inclusion and deduction would be hardly without consequence to churches. Under a deduction regime, churches might have to both account for their income and deductions to the IRS and to justify the appropriateness of such deductions (e.g., argue whether they are proper "ordinary and necessary expenses" under I.R.C. § 162). In doing so, significant "entanglement" between the State and churches emerges—an entanglement that society might wisely want to prevent. *See* EDWARD A. ZELINSKY, TAXING THE CHURCH 135–37 (2017).

[49] This literature, however, critically ignores what is well-known to marketers and behavioral economists: presentation matters. A broad range of studies shows that the presentation of a tax significantly affects people's perceptions of the tax and, as such, will inevitably affect behavioral and efficiency decisions. *See, e.g.*, Aradhna Krishna & Joel Slemrod, *Behavioral Public Finance: Tax Design as Price Presentation*, 10 INT'L TAX & PUB. FIN. 189 (2003) (summarizing the literature); Rachelle Holmes Perkins, *Salience and Sin: Designing Taxes in the New Sin Era*, 2014 BYU L. REV. 143 (discussing the behavioral and efficiency consequences of small changes in the design of otherwise identical sin taxes). As such, the functional-equivalence claim is wrong on its own terms.

[50] More importantly, these debates ignore that the law's form—in this case, deduction, credit, or exemption—has "expressive" power, even if a superficial functional analysis would deem the form irrelevant. Krishna & Slemrod, *supra* note 49, at 201 n.22; *see also* Kitty Richards, *An Expressive Theory of Tax*, 27 CORNELL J.L. & PUB. POL'Y 301 (2017) (discussing more broadly taxation's expressive powers); RICHARD H. MCADAMS, THE EXPRESSIVE POWERS OF LAW: THEORIES AND LIMITS (2015) (discussing the same). For example, recent empirical analyses found that the secondary *expressive* effects of the imposition of sin taxes (e.g., increased awareness by the public, increased social censure, increased media attention) can explain to a significant degree the sin taxes' efficacy. Alex Rees-Jones & Kyle T.

Resultingly, the theory need not explain the legal contours of deductions, credits, or any other "expenditure" that *should* be properly construed as incentives or subsidies—such as the Inflation Reduction Act's tax credits for green energy.[51]

This Article proceeds in four Parts. Part I provides a brief overview of the legal discourse surrounding tax exemptions, emphasizing the justifications articulated (or presumed) for the exemptions. Part II theorizes tax exemptions as the limits of tax and situates this theory within broader philosophical theories regarding the public sphere. In Part III, this Article maps the theory onto three central exemptions—the exemption for the nuclear family, the exemption for other sovereigns, and the exemption for charitable organizations—and will explore how the theory can explain and justify key aspects of the exemptions. Part IV then turns an eye to policy and discuss how the Limits Theory can aid in framing and rationalizing current policy controversies, such as the PIF–PGA Tour combination.

I. CURRENT PSEUDO-THEORIES

Tax scholars and policymakers have not sought a general theory of exemption that can comprehensively explain a broad range of exemptions. As the Joint Committee on Taxation notes, there is no widely accepted "unifying theme or singular principle that explains tax exemption for the many diverse organizations in the exempt sector."[52]

Although there are no well-developed or comprehensive theories of exemption, this Part aims to provide an overview of the main arguments and frameworks often invoked when justifying a particular exemption regime—most often when justifying the charitable regime as a subsidy (Subsidy

Rozema, *Price Isn't Everything: Behavioral Response Around Changes in Sin Taxes* 18 (Nat'l Bureau of Econ. Rsch., Working Paper No. 25958, 2022), https://www.nber.org/system/files/working_papers/w25958/w25958.pdf [https://perma.cc/SN66-WAML]. In other words, the expressive effects of the law might be just as effective in reducing consumption of the taxed good as the actual increase in price due to the tax. *Id.* at 20 n.22. These results strongly suggest that in the tax-exemption context, the framing of an "expenditure" as an exemption rather than as a credit or a deduction (even if hypothetically functionally equivalent, *see supra* note 49) would yield significant behavioral effects, given the difference in the expressive forms of the law. After all, an exempt organization is not only marked as effectively not having to pay income taxes but as one that, ab initio, might have been outside of the income tax dragnet. As a result, it should not be surprising that this Article aims to cover only exemptions—as these are both functionally and expressively different from other types of "expenditures."

[51] *See, e.g.*, 168 CONG. REC. S4069–70 (daily ed. Aug. 6, 2022) (statement of Sen. Ron Wyden) (remarking on the introduction of the Inflation Reduction Act).

[52] *See* JCT CHARITIES REPORT, *supra* note 24, at 8.

Theories).[53] This Part then develops the Subsidy Theories to provide a more accurate and balanced background for understanding and evaluating the Limits Theory.

In discussing the Limits Theory, this Part examines the Subsidy Theories and sets aside several competing pseudo-theories. This Part sets aside nihilistic or skeptical theories positing that no theory of exemption is possible or necessary; the attractiveness and value of the Limits Theory directly rebut such theories. In addition, this Part sets aside explanations that are generally viewed as too radical (or at least unhelpful in resolving legal policy debates): theories that generally subsume the law to economics, such as comprehensive, normative law-and-economics theories, or subsume the law to politics, such as Schmittian or Critical Legal Studies accounts.[54] (Even if these views were correct as a descriptive matter, it is questionable whether they are attractive as a normative one.)

Current commentary[55] and Supreme Court precedent[56] commonly envision tax exemptions—with most of the attention on the charitable exemption—as deliberate government subsidies to organizations engaged in (i) activities traditionally provided by the State or (ii) activities that are otherwise favored.[57] A traditional Subsidy Theory, therefore, generally argues that exemptions are justified because exempt entities lessen the State's burdens (and revenue needs) by providing certain services or goods that the State would have (or should have) provided otherwise—especially in cases of market or government failure.[58] This simple, traditional

---

[53] Another strand of theories that seek to justify the charitable exemption—"Base Theories"—is not discussed at length here. *See infra* notes 252–253 and accompanying text. As a result of the continuing criticism, the practical abandonment, and the limited applicability of these traditional Base Theories, the rest of this Article discusses the Limits Theory vis-à-vis Subsidy Theories. Such a move does not unduly sideline existing theories, as the Limits Theory is arguably a Base Theory—albeit one quite different from contemporary approaches to Base Theories, as it defines the Base Theory using values external to the tax in question, not internal to it (e.g., a soda tax should not tax juice sales, because juice is not soda).

[54] For a helpful review of these accounts' shortcomings in another context, see MICHEL ROSENFELD, A PLURALIST THEORY OF CONSTITUTIONAL JUSTICE 129–59 (2022).

[55] In fact, the Subsidy Theory served as the basis for five of the six main justifications the Congressional Joint Committee on Taxation listed for tax exemptions, the exception being Bittker's Base Theory. *See* JCT CHARITIES REPORT, *supra* note 24, at 68.

[56] The Court has repeatedly referred to tax exemption as a subsidy, displaying a heavy functionalism. *E.g.*, Regan v. Tax'n with Representation of Wash., 461 U.S. 540, 544 (1983) ("Both tax exemptions and tax-deductibility are a form of subsidy that is administered through the tax system. A tax exemption has much the same effect as a cash grant to the organization of the amount of tax it would have to pay on its income. Deductible contributions are similar to cash grants of the amount of a portion of the individual's contributions.").

[57] *See, e.g.*, Walz v. Tax Comm'n, 397 U.S. 664, 672–74 (1970).

[58] *See, e.g.*, Alexander v. "Ams. United" Inc., 416 U.S. 752, 772 (1974) (Blackmun, J., dissenting) (stating that § 501(c)(3)'s purpose was to "assure the existence of truly philanthropic organizations and the continuation of the important public benefits they bestow").

formulation is quite common and can be found everywhere from textbooks on nonprofits[59] to Supreme Court case law.[60] Despite its conspicuousness, this "theory" is usually underdeveloped or poorly articulated and lacks the sophistication of more fulsome accounts that seek to explain part of the charitable regime.[61]

Most contemporary sophisticated Subsidy Theories that seek to explain charitable tax exemption often use a law-and-economics framework, aiming to refine the traditional Subsidy Theory and to provide a sturdier justification for the exemption of nonprofit organizations. Although other law-and-economics theories on the nature of nonprofit organizations exist, Professor Henry Hansmann's has been the most influential and widely adopted.[62]

Hansmann prominently explained the income tax exemption of nonprofits on efficiency grounds, arguing that nonprofits will emerge where "contract failure" occurs. Contract failure will occur, for example, when patrons cannot easily assess the quality or quantity of the services for which they are contracting (e.g., medical services or donations to those in need).[63] Such goods or services are better or more efficiently provided by nonprofits because they openly are not profit-seeking; therefore, they have less incentive to cheat their customers and donors.[64] In sectors where the

---

59 *See, e.g.*, JAMES J. FISHMAN, STEPHEN SCHWARZ & LLOYD HITOSHI MAYER, TAXATION OF NONPROFIT ORGANIZATIONS: CASES AND MATERIALS (5th ed. 2021). While relatively unsophisticated, this theory tends to most closely align with traditional charity law. *See generally* GARETH JONES, HISTORY OF THE LAW OF CHARITY, 1532-1827 (1969) (discussing the origins of the law of charity in Elizabethan England and situating charity as part of a broader poverty-reduction project).

60 *See, e.g.*, *Regan*, 461 U.S. at 544; *Walz*, 397 U.S. at 672–74.

61 *See, e.g.*, Henry Hansmann, *The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation*, 91 YALE L.J. 54, 66–71 (1981) (discussing how traditional subsidy accounts are not equipped to explain why for-profit firms are not exempted despite providing services identical to those provided by nonprofit firms).

62 *See, e.g.*, JCT CHARITIES REPORT, *supra* note 24, at 72 (surveying the literature and focusing on Hansmann's theory).

63 Hansmann defines contract failure as "aris[ing] when, owing to the nature of the service itself or to the circumstances under which it is consumed, the purchasers of the service—whether we style them donors or consumers—are likely to have difficulty in (1) comparing the quality of performance offered by competing providers before a purchase is made, or (2) determining, after a purchase is made, whether the service was actually performed as promised." Hansmann, *supra* note 61, at 69.

64 HENRY HANSMANN, THE OWNERSHIP OF ENTERPRISE 229–30 (1996). More precisely, Hansmann argues that the nonprofit form is optimal where the patrons of an enterprise have sufficiently high contracting costs (because of asymmetric information) and high ownership costs (because of, for example, their customers' heterogeneity). *Id.* at 228. Professor Dan Shaviro convincingly criticizes Hansmann for failing to explain why the nonprofit does not emerge in other circumstances where patrons might also have high contracting costs and cannot verify the quality of the goods they buy—think of, for example, taking a car to the auto repair shop. *See* Dan Shaviro, *Assessing the "Contract Failure" Explanation for Nonprofit Organizations and Their Tax-Exempt Status*, 41 N.Y.L. SCH. L. REV. 1001, 1002–03 (1997). Shaviro notes that it might not be coincidental that the sectors where nonprofits emerge are "nonprofits

nonprofit form tends to emerge, however, underinvestment is likely[65] because investors cannot receive equity in return for their investment.[66] As a result, the exemption is necessary to subsidize these efficient firms in raising capital, given state law limitations on issuing ownership shares and distributing back capital to individuals.[67]

Many scholars have since attempted to refine, extend, or further develop Hansmann's theory of the charitable exemption. Most recently, Professor Louis Kaplow has sought to complement it with general efficiency justifications. Kaplow reframes the charitable subsidy as applying to organizations that engage in activities that generate positive externalities and connects these discussions to the optimal-tax literature.[68] Although remaining generally aligned with Hansmann, Professors John Colombo and Mark Hall have instead sought to ground tax exemption on a broader "donative theory" of charitable organizations.[69] Colombo and Hall argue that only charities that can attract substantial support from the public should be entitled to an exemption because donations are evidence of public value.[70] The tax exemption thus complements the donations and addresses free-rider problems that might arise in fundraising.[71] Others have sought to reframe their Subsidy Theories by stressing how the exemption promotes pluralism, allowing groups to provide different goods and services.[72] That is, charitable

---

in fields with a loosely charitable, virtuous, or public-spirited halo or aura" because they can attract motivated workers and donors. *Id.* at 1003–04. Moreover, the current applicability of Hansmann's theory in the information age is questionable. Third-party reviews and licensing boards can provide information for patrons, perhaps more efficiently than the signal of an organizational form. Experimental evidence of Hansmann's theory suggests that patrons prefer other informational signals to organizational form, even in cases where informational asymmetry is present in the contracting of goods. Chris Silvia, Curtis Child & Eva Witesman, *The Value of Being Nonprofit: A New Look at Hansmann's Contract Failure Theory*, NONPROFIT & VOLUNTARY SECTOR Q., Nov. 2023, at 18–19.

65 As Shaviro points out, from a theoretical perspective, this claim is not necessarily true. Shaviro, *supra* note 64, at 1006–07. Moreover, even if the underinvestment claim were true, it does not provide a reason for justifying the exemption without further elaboration as to the "goodness" or the "worth" of the otherwise-underprovided activities that those nonprofits are engaged in. *Id.* at 1007.

66 Hansmann, *supra* note 61, at 72–75.

67 *Id. But see supra* note 65 (arguing that there is no systematic reason to expect underinvestment).

68 *See* Kaplow, *supra* note 32, at 18–22. In addition to the externalities often associated with charitable enterprise (e.g., provision of public goods), Kaplow additionally considers externalities from voluntary redistribution, *id*. at 27, and externalities arising from private giving (i.e., both the donor and the donee experience welfare increases from charitable contributions). *Id.* at 25–26. For our purposes, I will generally refer to externalities in the public-goods and redistribution sense, without directly addressing the externalities supposedly arising from private giving that Kaplow identifies, which are more controversial in the literature.

69 COLOMBO & HALL, *supra* note 41.

70 *Id.* at 163–64.

71 *Id.* at 138; Mark A. Hall & John D. Colombo, *The Charitable Status of Nonprofit Hospitals: Toward a Donative Theory of Tax Exemption*, 66 WASH. L. REV. 307, 391–92 (1991).

72 *See* JCT CHARITIES REPORT, *supra* note 24, at 71 & n.186.

subsidies allow groups of like-minded citizens to provide important services that the State could not provide for logistical, political, or legal reasons.[73]

As discussed in more detail below, Subsidy Theories are at best incomplete, with considerable gaps in their ability to explain and justify our current legal regime. These theories fail to explain why we should subsidize organizations that either provide a good that is not a substitute for a State-provided good (e.g., churches[74]) or a good that the State or the market already provide (e.g., education and healthcare), both of which are subsidized by our current regime.[75] Similarly, these theories fail to definitively explain why the provision of externalities does not even come close to determining tax-exempt status: the law does not grant a tax exemption to Tesla, for example, despite the positive environmental externalities of electric vehicle usage, yet it provides an exemption to Greenpeace for analogous work[76]—all while also confusingly providing an exemption to the infamously anti-environmental People for the West![77] Moreover, Subsidy Theories fail to justify why every

---

73 *See, e.g.*, Paul R. McDaniel, *Federal Matching Grants for Charitable Contributions: A Substitute for the Income Tax Deduction*, 27 TAX L. REV. 377, 392, 406 (1972) (focusing on the importance of pluralism in the charitable deduction context and arguing in favor of a matching grant system instead); Saul Levmore, *Taxes as Ballots*, 65 U. CHI. L. REV. 387, 404–18 (1998) (arguing that the charitable deduction and the exemption allow taxpayers to "vote" for their preferred causes, resulting in the promotion of pluralistic causes that might not be otherwise promoted through the State); Rob Atkinson, *Altruism in Nonprofit Organizations*, 31 B.C. L. REV. 501, 629–30 (1990) (emphasizing how the exemption of nonprofits produces the meta-benefits of altruism and, relatedly, pluralism—benefits that cannot be easily achieved through the market or the State).

74 Accordingly, the case for churches' exemption has been challenged on many grounds. *See, e.g.*, Mark P. Gergen, *The Case for a Charitable Contributions Deduction*, 74 VA. L. REV. 1393, 1434–42 (1988) (arguing against the efficiency case for a deduction of charitable contributions to churches).

75 *See infra* Section III.C.2.; *see also* Rob Atkinson, *Keeping Republics Republican*, 88 TEX. L. REV 235 (2011) (noting that Subsidy Theories must also explain why nonprofit provision is preferable over government provision, especially when republican values would favor public, rather than private, provision).

76 *See* Anup Malani & Eric A. Posner, *The Case for For-Profit Charities*, 93 VA. L. REV. 2017, 2023–31 (2007). *Contra, e.g.*, Brian Galle, *Keep Charity Charitable*, 88 TEX. L. REV. 1213, 1233 (2010) (opposing "for-profit charities," even if they engage in "worthy" activities, because they "threaten[] to shift costs to charities, weaken the warm glow of giving, distort managerial incentives, and diminish or confuse donor choice"); Benjamin Moses Leff, *The Case Against For-Profit Charity*, 42 SETON HALL L. REV. 818, 864–65 (2012) (opposing for-profit charities as inefficient subsidies from the government's perspective). Professor Galle theoretically leaves an exception for "for-profit charity in those fields where low quality would result in little social harm. Theater, opera, and art all come to mind as potential examples." Galle, *supra*, at 1228.

77 At least until the organization disbanded. *See* Heidi Walters, *People for the USA! Disbands*, HIGH COUNTRY NEWS (Dec. 18, 2000), https://www.hcn.org/issues/issue-193/people-for-the-usa-disbands/ [https://perma.cc/NJT9-ZU5Z]; *see also* Sharon Beder, *People for the West!*, BUS.-MANAGED DEMOCRACY (2018), https://www.herinst.org/BusinessManagedDemocracy/environment/wise/PFW.html [https://perma.cc/F2R5-QZVD] (noting that People for the West! "became People for the USA! before being disbanded in 2001 in the face of declining membership and funding").

entity should be subsidized equally, forcing one to come up with explanations for the identical subsidization of an inefficiently run nonprofit theatre company serving the Upper East Side and an efficiently run charity feeding people experiencing poverty in rural Louisiana.[78] What do the Subsidy Theories explain if they cannot answer definitively the elementary questions of *who* and *how* to subsidize?

Although Subsidy Theories developed from attempts to explain and justify the charitable tax regime, they are often (perhaps unjustifiably) invoked to explain other exemptions. That is true in the context of the exemption for other sovereigns that Section III.B explores. For example, recent scholarship on the exemption for certain withholdings on investment income by sovereign wealth funds has uncritically justified it under a Subsidy Theory.[79] Scholars have similarly conceptualized the exemption for the nuclear family, which Section III.A discusses, treating the exemption for imputed income from housework as a subsidy.[80] Although scholarship has

The organization was an exempt § 501(c)(6) organization. *See People for the West! Membership Application Form*, PEOPLE FOR THE W.! (last revised July 20, 1996), http://web.archive.org/web/19970723204932/http://www.pfw.org/mbr_app.html. *See generally* Samantha Sanchez, *How the West Is Won: Astroturf Lobbying and the "Wise Use" Movement*, AM. PROSPECT (Nov. 19, 2001), https://prospect.org/environment/west-won-astroturf-lobbying-wise-use-movement/ [https://perma.cc/D23W-JXU5] (discussing the role of groups such as People for the West! in the anti-environmental movement of the 1990s).

78 That is not to say that scholars have not explored the equal rate of subsidization conundrum. Professor Miranda Perry Fleischer interestingly traces how different theories of justice would justify the distributional patterns that equally "subsidize" the opera and the soup kitchen. Professor Fleischer concludes that such equal subsidization is best justified under a theory resembling an expansive resource egalitarianism, finding that utilitarianism, classical liberalism, and libertarianism are all poor justifications for the distributional effects of our current regime. *See* Miranda Perry Fleischer, *How Is the Opera Like a Soup Kitchen?*, *in* PHILOSOPHICAL FOUNDATIONS OF TAX LAW 255, 260–75 (Monica Bhandari ed., 2017). As Professor Fleischer acknowledges, however, the kind of egalitarianism that would justify such a view is quite "controversial" and departs from popular mainstream egalitarian theories of justice by subsidizing people for "expensive tastes." *Id.* at 276–77; *see also* RONALD DWORKIN, SOVEREIGN VIRTUE: THE THEORY AND PRACTICE OF EQUALITY 104–06 (2000). As such, the justification for the subsidy's distributional consequences is at most partial, satisfying only those who subscribe to a somewhat controversial (and perhaps narrow) theory of justice—and highlighting the intellectual tension between theories of justice espoused, explicitly or implicitly, by prominent proponents of the Subsidy Theory (e.g., utilitarianism) and theories of justice that Professor Fleischer identifies as the most plausibly coherent with our current regime. Furthermore, a distinct (and unresolved) issue is whether an organization's *efficiency* in providing such services should affect the rate of subsidization. *Cf.* Linda Sugin, *Resisting the Corporatization of Nonprofit Governance: Transforming Obedience into Fidelity*, 76 FORDHAM L. REV. 893, 905–08 (2007) (discussing the lack of incentives for nonprofits to operate efficiently). As such, this issue is far from settled.

79 *See, e.g.*, Victor Fleischer, *A Theory of Taxing Sovereign Wealth*, 84 N.Y.U. L. REV. 440, 447 (2009) (dismissing the continuing legal relevance of sovereign immunity as a compulsory justification for the exemption and evaluating the exemption as a subsidy).

80 *See, e.g.*, Katharine Silbaugh, *Turning Labor into Love: Housework and the Law*, 91 NW. U. L. REV. 1, 83 (1996) (evaluating critically the exemption as a subsidy).

failed to comprehensively or generally visualize these exemptions through Subsidy Theories, the a prevalent assumption remains that exemptions—including the central exemptions discussed in this Article—are best explained and perhaps even justified as subsidies.

II. A THEORY OF THE LIMITS OF TAX

So, what is the logic behind tax exemption? This Article contends that our existing exemption regimes are best understood as the downstream results of normative judgments about the limits of the appropriate scope for taxation—limits that themselves reflect more primary normative judgments about the appropriate scope of the public sphere (and the State). In that way, tax exemptions are *not* the result of independent and individual policy judgments about how to fund public services optimally, provide public goods most efficiently, or incentivize positive externalities—as the literature, policy circles, and the courts have argued. Rather, exemptions are best seen as the result of primary sociopolitical judgments about the kinds of organizations and activities that should be kept outside of the public sphere—because those activities are, for example, part of a private sphere, another public sphere, or a hybrid space. Considering their position outside the public sphere relevant to U.S. federal income taxation, such organizations and activities are, therefore, judged to be exempt from the general and otherwise inexcusable mandatory civic obligation to contribute to the State through taxes.

On its face, a relationship between taxes and the public sphere should not be surprising. Perhaps axiomatically, taxation makes private resources public by making them accessible to the State for public use. In this way, taxation is not merely a mechanism to fund the State: there are many other plausible, distinct alternative funding mechanisms, such as the direct printing of money, the running of state-owned enterprises, voluntary contributions, or the collection of user fees.[81] Rather, taxation is a tool that marks the types of relations and activities that should—at least in part—contribute to the collective project of building and maintaining a "public."

Widespread conceptions of taxpaying thus perceive it as not merely a sterile ordinary transaction but rather a value-laden act, which originates from a broader relationship between the citizen and the State (however that

[81] There are many other plausible alternative funding mechanisms, such as the direct printing of money, the running of state-owned enterprises, voluntary contributions, or the collection of user fees. *See* Allison Christians, Introduction to Tax Policy Theory 3 (June 14, 2018) (unpublished manuscript), https://ssrn.com/abstract=3186791 [https://perma.cc/7F93-VLBB].

relationship might be construed).[82] Legal scholars have documented the normative valence of that relationship, with examples including the Boston Tea Party,[83] the movements for Puerto Rico's statehood and independence,[84] the campaign to exempt freed Black people from taxes as long as they were unable to vote,[85] and the drive to raise funds for the Second World War.[86] As these historical examples convey, taxes are related to abstract notions involving fiscal citizenship, the scope of the State, public benefits, and the public sphere.

But what exactly is this "public sphere"? This Article need not develop an elaborate conception of the "public" or the "public sphere"—especially given how these terms have developed sophisticated, contested, and specialized meanings in extensive political-philosophy debates.[87] Instead, for our purposes, it should suffice to draw from common elements of political-philosophy conceptions of the public sphere and define it as an area where interactions within a specified community take place that are (i) collectively judged to benefit a specified community (as opposed to benefiting particular

[82] *See* Tsilly Dagan, *The Currency of Taxation*, 84 FORDHAM L. REV. 2537, 2557–59 (2016) (highlighting the political and civic dimensions of taxpaying).

[83] *See* MICHAEL KEEN & JOEL SLEMROD, REBELLION, RASCALS, AND REVENUE: TAX FOLLIES AND WISDOM THROUGH THE AGES 6–11 (Joe Jackson & Jacqueline Delaney eds., 2021).

[84] *See, e.g.*, Diane Lourdes Dick, *U.S. Tax Imperialism in Puerto Rico*, 65 AM. U. L. REV. 1, 11–12 (2015) (critiquing the United States' domination over Puerto Rican tax and fiscal policies as a form of economic imperialism).

[85] Christopher J. Bryant, *Without Representation, No Taxation: Free Blacks, Taxes, and Tax Exemptions Between the Revolutionary and Civil Wars*, 21 MICH. J. RACE & L. 91, 107–10 (2015).

[86] *See* LAWRENCE ZELENAK, LEARNING TO LOVE FORM 1040: TWO CHEERS FOR THE RETURN-BASED MASS INCOME TAX 39–54, 71–110 (2013); AJAY K. MEHROTRA, MAKING THE MODERN AMERICAN FISCAL STATE: LAW, POLITICS, AND THE RISE OF PROGRESSIVE TAXATION, 1877–1929, at 6–15 (2013).

[87] *See generally* Seyla Benhabib, *The Embattled Public Sphere: Hannah Arendt, Juergen Habermas and Beyond*, 90 THEORIA 1 (1997) (summarizing some contemporary debates about the nature and scope of the public sphere).

individuals)[88] and (ii) undertaken with a special set of attitudes and virtues that display an orientation towards public benefit.[89]

We can start examining the relationship between taxpaying and the public sphere by stressing that the obligation to pay taxes is considered as a

---

[88] A general requirement that the public sphere operates for the benefit of the community is common to different strands of political philosophy, drawing from liberals such as Jean-Jacques Rousseau and Immanuel Kant but also from John Locke and St. Thomas Aquinas. *See, e.g.*, Jacqueline Pfeffer Merrill, *From Hobbes to Hayek: Perspectives on Civil Society and Philanthropy*, 23 INDEP. REV. 489, 492–93, 494–96 (2019) (discussing Rousseau, Kant, and Locke); 1–2 ST. THOMAS AQUINAS, SUMMA THEOLOGICA pt. II–I, q. 96, art. 1 (Fathers of the English Dominican Province trans., Benzinger Brothers, Inc. rev. ed. 1948) (1274). Disagreements arise once we start further specifying these terms, for example, in identifying how the public sphere should further the public benefit or how we should determine what is in the public benefit. *Compare, e.g.*, JOHN RAWLS, A THEORY OF JUSTICE 413, 456–58 (Harvard Univ. Press, rev. ed. 1999) (contrasting communities in which the members of society view one another as equals—as friends and associates joined together in a system of cooperation known to be for the advantage of all and governed by a common conception of justice with a "private society"), *with* ALASDAIR MACINTYRE, AFTER VIRTUE: A STUDY IN MORAL THEORY 174 (3d ed. 2007) (advancing a "form of community constituted by the shared project of achieving a common good and thus needing to recognize both a set of types of quality of character conducive to achieving that good - the virtues - and a set of types of action breaching the relationships necessary to such a form of community-the offences to be prosecuted by the community's law"); *and id.* xv (criticizing liberalism for taking the view that "government is to be neutral as between rival conceptions of the human good, yet in fact what liberalism promotes is a kind of institutional order that is inimical to the construction and sustaining of the types of communal relationship required for the best kind of human life").

[89] For many political philosophers, the public sphere is a space in which those attitudes and virtues are not only displayed but fostered. For Alasdair MacIntyre, virtues play an integral part of politics: "[P]olitical community not only requires the exercise of the virtues for its own sustenance, but it is one of the tasks of parental authority to make children grow up so as to be virtues adults . . . . The virtues are of course themselves in turn fostered by certain types of social institution and endangered by others." MACINTYRE, *supra* note 88, at 195. In this sense, the public sphere and these virtues are not only related, but co-constitutive.

The importance of certain "public sphere" virtues and behaviors presents itself in the work of liberal contractarians such as John Rawls, who have centered "reasonability" as a central value of "the public." *See* JOHN RAWLS, POLITICAL LIBERALISM 53–54 (expanded ed. 2005). Rawls's conception of reasonability implies an acceptance and toleration of other reasonable comprehensive doctrines. *Id.* at 60–61. Such values—the values of public reason—are central to Rawls's conception of political liberalism. *Id.* at 224–27. Critics of Rawls, such as Robert Nozick, similarly require that interactions in the public sphere embody certain virtues. Most saliently for Nozick, neutrality is a foundational value in constructing and operating the State. *See* ROBERT NOZICK, ANARCHY, STATE, AND UTOPIA 272–73 (2d ed. 2013).

Work by other current political philosophers continues to stress the importance of these virtues and attitudes to a definition of the public. Jürgen Habermas, *The Public Sphere: An Encyclopedia Article (1964)*, 3 NEW GERMAN CRITIQUE 49, 49 (1974) ("Citizens behave as a public body when they confer in an unrestricted fashion—that is, with the guarantee of freedom of assembly and association and the freedom to express and publish their opinions—*about matters of general interest*." (emphasis added)); *see also* HANNAH ARENDT, THE HUMAN CONDITION 50–58 (2d ed. 1998) (developing her conception of the public sphere). *See generally* Benhabib, *supra* note 87 (comparing Habermas's and Arendt's theories).

definitional matter as a general and universal obligation.[90] But, despite the general nature of this obligation, not everything is judged to be in scope to be responsible for contributing to the public through taxpaying—notwithstanding how important or value-laden taxpaying might be. Three examples that we will explore in Part III—the nuclear family, other sovereigns, and charities—evidence how broader sociopolitical judgments about the scope of the public sphere (judgments that are not idiosyncratic, but rather present in political philosophy of all stripes) delineate the limits of tax and require that certain entities be exempt from the otherwise general obligation to pay taxes.

As explored below, the law has charted the limits of tax in ways that embody sociopolitical judgments about the proper scope of the public sphere. First, an important line that delimits the public sphere separates it from relationships conceived as too primal or private to be included within the public sphere—with the nuclear family as a paradigmatic but contested example. Political theorists from Plato and Aristotle to Jean-Jacques Rousseau and G.W.F. Hegel[91] have traditionally distinguished between the "'private' domestic life and the 'public' life of politics and the marketplace."[92] Contemporary political theories of all stripes—from John Rawls's liberalism to Robert Nozick's libertarianism and communitarianism à la Professors Michael Sandel and Alisdair MacIntyre—have retained this distinction, echoing earlier theories by emphasizing how family matters were too personal or private to be included in the public sphere.[93] Including the family in the public sphere would radically change the values and purposes of the family, transforming an association that exists for private benefit and in which generosity and love are supreme virtues into a supposedly sterile association organized for the public benefit where neutrality and justice are more important.[94] That is not to say that these intuitions are uncontested: Communist and feminist scholars such as Susan Miller Okin have long

[90] Although this would seem like a grand, unsupported assumption, this starting assumption is buttressed by both general models of governmental action, *see supra* notes 33–34 and accompanying text, and more specific theories on the income tax such as Haig–Simons income, *see supra* note 38. Whether this assumption ultimately finds support in optimal income tax theories or political philosophy is irrelevant to this Article's argument.

[91] *See* JEAN BETHKE ELSHTAIN, PUBLIC MAN, PRIVATE WOMAN: WOMEN IN SOCIAL AND POLITICAL THOUGHT 17–19 (2d ed. 1993) (examining the existence and discussing the evolution of the public and private spheres in traditional Western political thought).

[92] *See* SUSAN MOLLER OKIN, JUSTICE, GENDER, AND THE FAMILY 8 (1989).

[93] *See infra* Section III.A.

[94] *Cf.* MICHAEL J. SANDEL, LIBERALISM AND THE LIMITS OF JUSTICE 31–34 (2d ed. 1998).

sought to tear down the boundaries keeping the family outside of the realm of public inquiry and analysis.[95]

These assumptions about the private character of the family and its proper exclusion from the public sphere also play out in tax.[96] In fact, despite strong policy arguments to the contrary, economic interactions between spouses are generally disregarded for tax purposes, generally "with men occupying the 'public' sphere and women occupying the 'private' domestic sphere."[97] As a result, the income from housework and child-rearing, presumed to be private "women's work," is exempt from taxation, notwithstanding Haig–Simons's insistence on it being taxed.[98] Yet this exemption is no harmless or minor oversight: by some estimates, the exemption covers a *trillion* dollars in annual economic activity and is a significant driver of gender (and racial) inequity in the family and in the labor market.[99] These deviations from "optimal" policy and pseudo-exemptions evidence judgments about the division between the public and the private sphere and about the State's ability (or inability) to regulate the family.

A second subject of delimitation for the public sphere is fundamental: the division among different public spheres. Widely shared notions of comity (and in the domestic context, federalism) imply that the public sphere's limits be charted in relation to other coexisting public spheres.[100] Notions of comity and federalism are easy to grasp and locate within social and political theory. After all, our post-Westphalian legal order[101] presupposes that, as jurist Emer de Vattel famously stated, there be "a perfect equality of rights between nations, in the administration of their affairs and the pursuit of their

95 *See generally* OKIN, *supra* note 92 (arguing the dichotomy between the public and private spheres is largely an "ideological construct" leading to the exclusion of marriage and the family from discussions on justice); Deborah Kearns, *A Theory of Justice—and Love; Rawls on the Family*, 18 POLITICS 36 (1983) (arguing that justice must "necessarily exist [in the private world of the family] if it is to exist in the broader public sphere").

96 Many theorists have, in passing, intuited this limit to taxation. *See, e.g.*, Dagan, *supra* note 82, at 2556 ("Like the family unit and charitable associations, the *kibbutz*, driven by its ideology, promotes (and produces) a unique value that the market is unable to produce and which could be thwarted by introducing the currency of taxation if applied indiscriminately . . . .").

97 Nancy C. Staudt, *Taxing Housework*, 84 GEO. L.J. 1571, 1571 (1996).

98 *Id.* at 1618–40 (providing a forceful case against the tax exemption of housework, rebutting valuation, liquidity, and commodification critiques).

99 Wezerek & Ghodsee, *supra* note 28.

100 *See infra* Section III.B.2.

101 *See generally* OONA A. HATHAWAY & SCOTT J. SHAPIRO, THE INTERNATIONALISTS: HOW A RADICAL PLAN TO OUTLAW WAR REMADE THE WORLD (2018) (tracing the birth of our current international law regime).

pretensions."[102] Although these lofty principles originated in the context of international legal relationships, they were soon imported into intranational legal relationships through federalism.[103]

In that sense, activities in and members of a state should be responsible for contributing to the public benefit of that state alone—at least absent a particular relationship with another state—despite ever-present incentives to opportunistically tax other states' activities and members.[104] That sociopolitical intuition underlies not only our post-Westphalian legal order but also our international tax system[105] and its principles of source and residence—even in the face of recent system overhauls.[106]

Political theory considerations of equity, comity, and federalism among the several states have unsurprisingly guided a wide array of exemptions for other sovereigns throughout U.S. tax history, from the birth of the intergovernmental tax immunities doctrine in *McCulloch v. Maryland*[107]—which exempted from tax the activities of state and local governments that would regularly be thought of as existing within the ordinary scope of the federal government tax power—to more recent legislative enactments

[102] EMER DE VATTEL, THE LAW OF NATIONS 75–76 (Knud Haakonssen, Béla Kapossy & Richard Whatmore eds., Thomas Nugent trans., 2008). Such notions of equality and independence are often represented by the international law maxim of *par in parem non habet imperium*. *See* JAMES CRAWFORD, BROWNLIE'S PRINCIPLES OF PUBLIC INTERNATIONAL LAW 448–49 (9th ed. 2019).

[103] *See, e.g.*, Anthony J. Bellia Jr. & Bradford R. Clark, *The International Law Origins of American Federalism*, 120 COLUM. L. REV. 835 (2020); William S. Dodge, *International Comity in American Law*, 115 COLUM. L. REV. 2071 (2015).

[104] *See* Joel B. Slemrod, *Free Trade Taxation and Protectionist Taxation*, 2 INT'L TAX & PUB. FIN. 471, 476 (1995).

[105] *See* Reuven S. Avi-Yonah, *International Tax as International Law* 12–15 (Univ. of Mich. L. Sch., Working Paper No. 04-007, 2004); Dagan, *supra* note 82, at 2559–62 ("The bottom line is that the currency of taxation—which is either the price tag attached to membership in a national community or the list of criteria establishing one's residency—sets the value of existing and potential membership in the community. It forces members to weigh their national commitments against tax liabilities and translates belonging to the political community of the state into a set of technical criteria that determine residency."); Clyde J. Crobaugh, *International Comity in Taxation*, 31 J. POL. ECON. 262 (1923) (tracing the historical relationship between comity and the problem of double taxation).

[106] Michael J. Graetz & Michael M. O'Hear, *The "Original Intent" of U.S. International Taxation*, 46 DUKE L.J. 1021, 1088–89 (1997) (discussing the origins of the permanent establishment construct that undergirds international taxation today). Traditionally, source-and-residence taxation was the dual paradigm on which tax jurisdiction was built. However, Pillar One aims to upend that traditional consensus and redefine the applicability of the construct of "permanent establishment" by allowing market jurisdictions to tax a portion of large multinational enterprises' residual profit. *See* Reuven Avi-Yonah, Young Ran (Christine) Kim & Karen Sam, *A New Framework for Digital Taxation*, 63 HARV. INT'L L.J. 279, 290–95 (2022). That is, Pillar One aims to fundamentally alter the international allocation of taxing rights, giving market jurisdictions a portion of profits they would not have been entitled to under the League of Nations' traditional allocation.

[107] 17 U.S. (4 Wheat.) 316, 395 (1819).

exempting from taxation certain types of income by sovereign wealth funds.[108]

Lastly, a third limit of the public sphere—and ordinary taxation—excludes charities. Although it covers a dizzyingly broad array of organizations—from churches and educational institutions to Meals on Wheels and People for the Ethical Treatment of Animals (PETA)—the charitable exemption regime can be seen as embodying a judgment that "hybrid" *private* and autonomous organizations that operate consonant to the public sphere towards the *public* benefit should not be included within its scope.

Political theorists have sought to maintain these organizations outside the scope of the State and the public sphere because including them would imperil their autonomy and ability to provide unique goods and services. These organizations can provide unique goods and services *precisely* because they are not part of the State; these associations allow similarly minded people to advance their collective goals—goals that could only be provided at a small scale, are idiosyncratic, or in some way would lose their worth through public or market provision. Nozick, for example, highlights the importance of these associations in his libertarian utopia, seeing them as a uniquely valuable and *noncoercive* form of collective organization providing an alternative to the State.[109] MacIntyre conceives of these associations as essential to allow people to pursue collective goods and develop virtues that will enable them to flourish—yet subjection to the logic of the State or the market would endanger these forms of organization.[110] Lastly, Rawlsian liberals have seen associations such as charities as a key site to develop moral attitudes that allow a pluralist society to prosper.[111] As a result, they chart charities outside of the public sphere, insulating them from the State and the market.

The limitations of tax—which theorists have ignored while seeking to establish a normative relationship between taxpaying and the State—are thus neither given nor arbitrary. On one dimension, taxation's limits are

[108] *See infra* Section III.B.1.

[109] *See* NOZICK, *supra* note 89, at 311–12 (describing utopia and highlighting the importance of autonomous organizations in individuals' collective pursuit of their own version of the good).

[110] *See infra* note 281.

[111] RAWLS, *supra* note 88, at 413; *see also* Linda Sugin, *Rhetoric and Reality in the Tax Law of Charity*, 84 FORDHAM L. REV. 101, 118–19 (2016) (arguing that the deduction should not be understood as a way in which the government fosters the provision of essential public goods by private entities, such as education, but rather as a way in which the government fosters private associations that provide goods allowing people to pluralistically pursue their version of the good); Chiara Cordelli, *Justice Below the State: Civil Society as a Site of Justice*, 46 BRIT. J. POL. SCI. 915, 917–18 (2016) (arguing for the importance of organizations beneath the State to Rawls's theory of justice).

circumscribed in relation to other public spheres. On another dimension, their scope is circumscribed by relationships and interactions too primal to commandeer to contribute to the collective project of the State. On yet another, the limits are drawn to "protect" charities as autonomous private organizations pursuing ends consonant with the public benefit. These limits reflect collective judgments, evidenced in a wide variety of representative political theories, about the proper sphere of State action and awareness of how taxpaying imbues transactions with a certain public meaning, which in some contexts is inapposite.

III. Charting the Limits

With an understanding of what the Limits Theory entails, we can now explore its roots in three different exemption regimes: the nuclear family, other sovereigns, and charities. These three contexts reveal different sociopolitical judgments that underlie their exemptions: housework within the family is too primal or private for the State to tax; other sovereigns seem inappropriate to tax based on notions of comity and federalism; and charities' hybrid private–public nature and autonomous character merits exemption for their protection.

These three exemptions are thus not only representative insofar as they constitute an almost-comprehensive swath of exemptions in general—both as a matter of number and economic magnitude[112]—but also insofar as they outline different types of rationales for exempting an activity or organization from the public sphere and ordinary taxation. As a result, the theory inducted from these exemptions should be generally applicable throughout the tax exemption landscape.[113]

A. The Family

1. The Law

The fundamental question of how to tax familial interactions has plagued income tax law since its birth. So much so that the book that crystallized the Haig–Simons definition of "income" that we still use today, *Personal Income Taxation* by Henry Simons, treats the problem at length.[114] Simons, one of the original proponents of a wide conception of "income," nonetheless noticed that taxing familial interactions—most specifically,

---

[112] *See supra* note 28.

[113] *See supra* note 29.

[114] *See* Simons, *supra* note 38, at 50 (building on the definition of income that Haig initially conceived of in *The Federal Income Tax*, *supra* note 38).

taxing income from household work—posed uncomfortable puzzles for his theory of income taxation.

To evidence the problem, Simons compared the federal income tax treatment of two hypothetical households with identical pre-tax incomes, one in which Mrs. A stayed at home to do the housework and one in which Mrs. B worked outside of the household and used all her income to hire a maid to do the housework.[115] From a Haig–Simons perspective, measuring income from a theoretical perspective, both are equally well-off: both Mrs. A and Mrs. B worked and as a result of their efforts had their (and their partner's) housework done, so both of them should have the same amount of income.

The federal income tax treatment of this labor decision (i.e., to work within the home rather than within the market) and the treatment's departure from the demands of traditional tax principles are well understood: Mrs. B is taxed on the wage income she must earn to pay her maid, whereas Mrs. A's "earned income in kind" is exempt from taxation altogether. Consequently, the tax system's exemption inequitably favors Mrs. A (the stay-at-home worker), despite her having an identical pre-tax *economic* position as Mrs. B.[116]

2. *The Family as Private Sphere and the Exemption of Imputed Housework Income*

Simons himself recognized the "impropriety" and inequity of this result—but he did *not* recommend the taxation of Mrs. A's "earned income in kind." Why would the father of our expansive definition of income defend an exemption that was so clearly at odds with his theory? "In general . . . it would seem that considerations of justice, not to mention those of administration, argue here for rather narrow definition of taxable income."[117]

Simons was not alone in arriving at this uncomfortable compromise; a father of law-and-economics, Judge Richard Posner, similarly criticized this exemption as unprincipled and inefficient. Posner, however, sided with Simons, and with an uncharacteristic lackadaisical attitude, declared without evidence or elaboration that the "administrative costs" of enforcing

[115] *Id.* at 111. Of course, these examples have often assumed that the marginal worker was a woman in a heterosexual marriage, an assumption that has been further explored and problematized by feminists discussing this area of the law. *See, e.g.*, Staudt, *supra* note 97, at 1571.

[116] SIMONS, *supra* note 38, at 111. This inequality is well understood in the literature and is discussed even in introductory tax textbooks. *See, e.g.*, MICHAEL J. GRAETZ & ANNE L. ALSTOTT, FEDERAL INCOME TAXATION: PRINCIPLES AND POLICIES 114–16 (9th ed. 2022) ("Although we may think the failure to tax the value of walking one's dog or combing one's hair is of academic interest only, the failure to tax the services provided by homemakers has undoubtedly influenced the decisions of some women to stay at home rather than to enter the work force [sic].").

[117] SIMONS, *supra* note 38, at 111–12.

an inclusion "would be so great, however, that this exemption is probably a permanent feature of income taxation."[118] Yet critics of the exemption, such as scholar Nancy Staudt, have forcefully rebutted these administrability concerns.[119] Valuation problems can be practically addressed by importing definitions of productive noncash labor that are well-developed in economics literature and by imputing such income using population-wide estimates from time-use studies to this type of labor.[120] (These "rough justice" approaches have certainly been deemed sufficient in neighboring tax provisions, such as those providing deductions for dependents and calculating the Earned Income Tax Credit.)[121] Liquidity problems (and distributional concerns) could be addressed by pairing the imputed income with across-the-board deductions or credits for childcare costs, which would both retain tax neutrality among childcare decisions (the most significant component of housework) while reducing the burden of the tax on low-income families.[122] Staudt's work demonstrates that administrative issues, while seemingly daunting, are manageable—especially when addressing a policy issue that imposes considerable costs on women and the fisc. As Simons seemed to recognize, the exclusion does not merely (or even primarily) stem from administrability concerns. Rather, Simons vaguely justified the exemption by reference to "considerations of justice."[123] (For his part, Posner echoes a similar justification for the exemption, emphasizing public perceptions of fairness in his justification.)[124]

But how can we justify this exemption as a just, fair, or even good subsidy? Subsidy accounts lack the requisite conceptual and normative resources to justify the exemption. They face the unenviable task of justifying the exemption as a worthwhile subsidy without recourse from the traditional criteria for a subsidy in tax policy, such as efficiency or equity. After all, the exemption significantly distorts labor-market participation in ways that disproportionately affect women, which is widely perceived

---

[118] Richard A. Posner, *Taxation by Regulation*, 2 BELL J. ECON. & MGMT. SCI. 22, 42 (1971). Posner's administrability "analysis" is clearly incomplete. As Kaplow notes, "many of these deviations from a comprehensive tax base are akin to differential commodity taxation . . . . The analysis there will suggest that most departures from uniformity are likely to be suboptimal. For those resulting from administrative convenience, direct cost savings should be traded off against the cost of distortions." LOUIS KAPLOW, THE THEORY OF TAXATION AND PUBLIC ECONOMICS 94–95 (2008).

[119] *See* Staudt, *supra* note 97, at 1620–27.

[120] *Id.* at 1622.

[121] *Id.* at 1623, 1625–26.

[122] *Id.* at 1636–40.

[123] SIMONS, *supra* note 38, at 112.

[124] Posner, *supra* note 118, at 42.

as inefficient.[125] The exemption is additionally inequitable from both horizontal- and vertical-equity perspectives[126]—not to mention the exemption's substantial race and gender inequities.[127] As a result, it is hard to justify such a policy as a *subsidy* adopted for efficiency or equity reasons.

Some, such as Posner, have alternatively suggested that the exemption is a practical decision, and if housework were taxed, the law would have to impute tax on all other types of nonpecuniary transactions.[128] For example, the law would have to tax a painter who paints a lawyer's house in exchange for the lawyer's legal services. This line of reasoning faces two problems. First, albeit inconsistently, the law *does* seek to tax imputed income in some circumstances: The law plainly states that both the painter and the lawyer have income from their barter transaction—despite no cash changing hands.[129] As such, repealing the exemption would only make the law more—not less—consistent. Second, as to the slippery-slope argument, there is no reason why not exempting housework would lead to the taxation of all sorts of self-provided services. After all, the exemption of housework is uniquely flawed and can easily be distinguished from other contexts. The exemption covers, by some estimates, more than a trillion dollars (!) of annual economic activity.[130] Moreover, the distributional consequences are particularly dire given the unfair distribution of housework from a gender, race, and ethnicity perspective, resulting in disproportionate disincentives for women—especially Black and Latina women—to work in the market.[131]

Without traditional tax policy rationales available to explain or justify the exemption, how can we make sense of taxation's seemingly unjustified exemption for housework within the family? Posner's and Simons's positions, stating that people would not "understand its rationale" and would

[125] These effects have long been understood, even in legal circles. *See, e.g.*, Edward J. McCaffery, *Slouching Towards Equality: Gender Discrimination, Market Efficiency, and Social Change*, 103 YALE L.J. 595, 617–19 (1993).

[126] RICHARD A. MUSGRAVE & PEGGY B. MUSGRAVE, PUBLIC FINANCE IN THEORY AND PRACTICE 365 (Scott D. Stratford ed., 5th ed. 1989); Boris I. Bittker, *Federal Income Taxation and the Family*, 27 STAN. L. REV. 1389, 1425–26 (1975).

[127] Vanessa R. Wight, Suzanne M. Bianchi & Bijou R. Hunt, *Explaining Racial/Ethnic Variation in Partnered Women's and Men's Housework: Does One Size Fit All?*, 34 J. FAM. ISSUES 394, 418–19 (2012) (examining gender and racial imbalances in the division of housework, finding that women do most of the housework and that the gender gap is greater in Hispanic and Asian households).

[128] Richard A. Posner, *Conservative Feminism*, 1989 U. CHI. LEGAL F. 191, 193 ("Otherwise there would be no economic explanation for failing to tax all significant nonpecuniary goods, notably leisure."); *see also* Mark G. Kelman, *Personal Deductions Revisited: Why They Fit Poorly in an "Ideal" Income Tax and Why They Fit Worse in a Far from Ideal World*, 31 STAN. L. REV. 831, 841–44 (1979) (arguing that the relevant line is whether the labor provided was provided within the market).

[129] Rev. Rul. 79-24, 1979-1 C.B. 60–61.

[130] *See supra* note 28 (estimating the magnitude of the exemption).

[131] *See* Wight et al., *supra* note 127.

"greatly resent" such a tax as "[i]t would seem like a tax on motherhood"[132] or would contravene "justice,"[133] hint at the Limits Theory.[134] Although gendered and outdated, these public understandings theorize work done inside the household—still primarily by mothers and other female family members—as somehow exclusively pertaining to the family, not to the public sphere.[135] Because of this dubious distinction, Mrs. A's income from housework and childcare escapes taxation, notwithstanding Haig–Simons's insistence on it being taxed.[136]

But is the family *outside* the public sphere? The family is perhaps the paradigmatic example of a fundamental limit on the public sphere, commonly called the "private sphere." Unlike the public sphere, the family is (i) paradigmatically oriented to the private good of the family—not the public—and (ii) constituted in opposition to public-sphere virtues such as neutrality, impersonality, and impartiality.[137] The sociopolitical judgments that place the family outside of the regular confines of the public sphere are evident from even the most cursory glance at political philosophy of all stripes. (While the practice has been contested prominently by feminists and socialists,[138] the sociopolitical judgment has remained widespread.)

Liberals such as John Rawls, for example, conspicuously placed the family outside of the public sphere. With "heads of households" representing their own families in the "original position," Rawls's key thought experiment meant to arrive at fair principles of justice.[139] Moreover, Rawls refused to apply the principles of justice to the family, assuming this fundamental unit was just and therefore outside of the regular analysis.[140] While unsaid, these

---

132 Posner, *supra* note 128, at 193.

133 SIMONS, *supra* note 38, at 112.

134 In a similar vein, Professor Mark Kelman has argued in neighboring literature that exemption of this kind of labor hinges on whether a taxpayer has "voluntar[ily] ent[ered] into the market" and argued based on both leftist-commodification and contractualist-libertarian arguments that nonmarket housework is somehow too private to tax. *See* Kelman, *supra* note 128, at 838, 842 (discussing leftist noncommodification arguments for the exclusion of nonmarket labor); *see also id.* at 842 n.33 (discussing libertarian arguments for the taxation of nonmarket labor).

135 *See infra* note 146.

136 *See* Staudt, *supra* note 97, at 1618–40 (providing a forceful case against the tax exemption of housework, rebutting valuation, liquidity, and commodification critiques).

137 *Cf. supra* notes 87–89 and accompanying text.

138 *See, e.g.*, Richard Weikart, *Marx, Engels, and the Abolition of the Family*, 18 HIST. EUR. IDEAS 657 (1994) (exploring Marx and Engels's ideas on abolishing the family as part of their broader political project).

139 *See* RAWLS, *supra* note 88, at 111. As Susan Moller Okin points out, Rawls draws on a long tradition assuming that "justice is not an appropriate virtue for families," embodied most clearly in the writings of Rousseau and David Hume. *See* OKIN, *supra* note 92, at 26–27.

140 Susan Moller Okin, *'Forty Acres and a Mule' for Women: Rawls and Feminism*, 4 POL., PHIL. & ECON. 233, 237–39 (2005) (summarizing feminist critiques of Rawls).

assumptions hinted at Rawls's implied acceptance of the long-existing public and private dichotomy, which works to

> separate out and to shape the sphere in which men, perceived as autonomous, independent, and often self-interested individuals, had rights and made contracts and the sphere in which women took care of the daily needs of the supposedly autonomous men and of children—the sphere in which bonds were assumed to be naturally hierarchical and motivations altruistic.[141]

Feminist scholars have challenged this assumption, pointing out that because "neither families nor the divisions of labor within them can be conceived of as natural, in the sense of being unaffected by coercive laws," the State thus cannot refuse to operate within the family.[142]

Rawls is not the only prominent theorist who has insisted on, or at least assumed, a division between the nuclear family's public and intimate private spheres. As Susan Moller Okin convincingly illustrates, such division is evident in families' inconspicuous absence in lengthy political discussions of justice, which deem the subject of family generally to be irrelevant or minor—as Nozick's libertarian account[143] and MacIntyre's communitarian account do.[144] Yet even accounts that explicitly consider the family when theorizing the public sphere—such as Sandel's communitarian account—further reify the distinction between the public sphere and the intimate private sphere of the family, highlighting, for example, that the family is "beyond justice."[145]

It should thus be no surprise that judgments regarding the private character of the family and its proper exclusion from the public sphere have trickled down to play a prominent role in legal and tax discourse, both by

---

[141] *Id.* at 239.

[142] *Id.*

[143] *See* OKIN, *supra* note 92, at 74–76, 87 ("[T]he family and a large part of the lives of most women, especially, are assumed by [Nozick's] theory but are not part of it in the important sense of having its conclusions applied to them."); NOZICK, *supra* note 89, at 167 (criticizing Rawls for applying his patterned principles to the family, and suggesting that principles of justice should not apply to the family).

[144] *See* OKIN, *supra* note 92, at 55–72 (criticizing MacIntyre's obliviousness to historical traditions' role in sustaining an oppressive and unjust family structure). *But see, e.g.*, ALASDAIR MACINTYRE, WHOSE JUSTICE? WHICH RATIONALITY? 104–05 (1988) (acknowledging how Aristotelian political thought denied women citizenship but arguing that this idea was a product of a contingent and oppressive social context, so the Aristotelian tradition could dispose of those ideas in a different social context).

[145] *See* SANDEL, *supra* note 94, at 31–34; OKIN, *supra* note 92, at 27–28.

academics[146] and courts.[147] That is why, despite the strong contrary policy arguments discussed above, our system generally disregards economic interactions between spouses for tax purposes, creating an exemption for the resulting income.

This insistence on a division between the public sphere and "the family"[148] exists beyond this Article's focus, in taxes different from the federal income tax,[149] especially in the transfer tax system. Spousal transfers are generally exempted from the gift tax, reflecting a policy judgment seeking to favor "gifts and bequests within the family."[150] Other transfers are similarly exempted, such as limited gifts to minors[151] and gifts to cover education and medical expenses.[152] Although these exemptions do not currently require familial relationships, they evolved from provisions that did—and from social understandings about the obligations inherent in a

[146] *See supra* note 96; Anne L. Alstott, *Family Values, Inheritance Law, and Inheritance Taxation*, 63 TAX L. REV. 123, 127 (2009) (discussing the role of the family in inheritance taxation and noting that "[t]he liberal family, in the U.S. tradition, treats the family as a private sphere, a place where consenting adults come together to define mutually agreeable relationships and a shared way of life"); Staudt, *supra* note 97, at 1571 ("Many features of the Federal Income Tax Code reflect the assumption that our society is composed of heterosexual married couples, with men occupying the 'public' sphere and women occupying the 'private' domestic sphere."). Moreover, this treatment of housework—as too intimate or private to be adequately addressed by law—is evident not only in tax, but prevalent throughout the law. *See* Silbaugh, *supra* note 80, at 27–79.

[147] In *Smith v. Commissioner*, for example, the Board of Tax Appeals rejected the deductibility of childcare expenses as business expenses, reasoning that childcare was of "personal concern" and that "[t]he wife's services as custodian of the home and protector of its children are ordinarily rendered without monetary compensation." 40 B.T.A. 1038, 1039 (1939).

[148] Even in tax policy alone, several ideals of "the family" are at play. Alstott, *supra* note 146, at 125. Different ideals of the family will imply different tax regimes. *Id.* at 125–26 (discussing the implications for inheritance taxation).

[149] Section 1014's "step-up" in basis arguably presents another instance of this familial exemption. The provision has its roots in its coordination with the estate tax system, which is plagued with exemptions for the family. Congress structured the provision to protect the family from taxation at the time of death and was designed with a traditional married family in mind. *See* Jeremy T. Ware, *Section 1014(b)(6) and the Boundaries of Community Property*, 5 NEV. L.J. 704, 706 (2005).

[150] *See* I.R.C. § 2523(a); Alstott, *supra* note 146, at 131–32. Although intuitive, this rule is not uniform worldwide, with significant divergence among systems. *See, e.g.*, Flávia Allegro Gerola, *Gift Tax Consequences Between Spouses of Different Citizenships: A Comparative Analysis Between American and Brazilian Laws*, 31 PROB. & PROP. 54 (2017) (comparing American and Brazilian gift tax laws).

[151] I.R.C. § 2503(c).

[152] *Id.* § 2503(e)(2).

parental relationship.[153] Today, the social imaginary continues to envisage intrafamilial transfers as the paradigm for such exemptions.[154]

The exemption for income from housework is thus best understood as reflecting sociopolitical judgments about the proper scope of the taxation of the family, which in turn reflects sociopolitical judgments about the scope of the "public sphere" in relation to the family. As evidenced by political theories of all stripes and their resulting downstream legal debates, there "is a widespread tendency to think of families—especially housework and childrearing—as too primal or intimate to tax. Although ostensible reasons for their exemption might exist (e.g., administrative difficulties in imputing income), taking a step back and considering the policy in context suggests that the driving justification for the exemption is the family's unique location outside of the limits of the public sphere and ordinary taxation.

This is not to say, however, that the family is untouched or unaddressed by taxation; the family is regulated head-on by a myriad of provisions—just think of the Earned Income Tax Credit (EITC) or the Child Tax Credit (CTC).[155] These types of provisions, however, do not implicate the same normative concerns in the collective consciousness, as they have been traditionally understood to be either anti-poverty or pro-work programs.[156] Further, policymakers and activists have indeed historically pushed back on intrusive qualification provisions for these programs, arguing that they unjustifiably intrude upon or seek to control the private family sphere.[157] Moreover, these interventions in the family should be kept in perspective—

[153] For example, an early predecessor of the current federal transfer taxes—the 1862 inheritance taxes—taxed the recipient based upon the "closeness of the familial relationship between the decedent and the beneficiary." *See* JOHN R. LUCKEY, CONG. RSCH. SERV., 95-444 A, A HISTORY OF FEDERAL ESTATE, GIFT, AND GENERATION-SKIPPING TAXES 4 (2003). Some inheritance tax systems, such as France's, preserved this feature. *See* Alstott, *supra* note 146, at 132 & n.28; *cf.* Bittker, *supra* note 126, at 1444–45 (discussing the dependency exemptions and concluding that "[i]t is a reasonable inference that most of these dependency exemptions are for children whom the taxpayer is legally obligated to support," but also that "some are for adult children and other persons, who qualify for the deduction even though the taxpayer's contributions are prompted not by legal compulsion but by moral responsibility, family pressure, generosity or other impulses that only a psychoanalyst could expose").

[154] *See, e.g.*, Dickman v. Commissioner, 465 U.S. 330, 340–42 (1984); Bittker, *supra* note 126, at 1444–45.

[155] I.R.C. §§ 24, 32.

[156] *See, e.g.*, MARGOT L. CRANDALL-HOLLICK & JOSEPH S. HUGHES, CONG. RSCH. SERV., R44057, THE EARNED INCOME TAX CREDIT (EITC): AN ECONOMIC ANALYSIS (2018) ("In the 1990s, the purpose of the credit was expanded to include poverty reduction, with a focus on encouraging welfare recipients—generally unmarried mothers—to work. At the time, the EITC was seen as a way to ensure that a full-time worker with children would not be in poverty.").

[157] The Aid to Families with Dependent Children program, for example, received strong criticism for contributing to a long history of "attempts to control [the lives of poor women] by conditioning public welfare on their compliance with morality requirements." Naomi R. Cahn, *Representing Race Outside of Explicitly Racialized Contexts*, 95 MICH. L. REV. 965, 972 (1997).

in a year, the exemption of household labor likely costs the government more than the *combined* outlays for the EITC *and* the CTC.[158] As a result, although there are indeed instances where the tax system approaches or regulates the private family sphere, non-tax grounds tend to justify such tax provisions, which tend to be less significant on aggregate than the exemptions granted to household labor.

B. Other Sovereigns

1. The Law

The tax treatment of one government by another has, perhaps unsurprisingly, been a perpetually contested area of the law. In fact, early disputes over the scope of federal power—from the federal response to the Whiskey Rebellion[159] to the Court's seminal decision in *McCulloch v. Maryland*[160]—were quite plainly disputes about the exact contours of sovereigns' taxing powers. Despite this conflict-laden history, our tax regime now provides a relatively stable and broad array of exemptions to other governments' activities, investments, and agents.[161]

Most prominently, our federal income tax system exempts state and local governments' income from "essential activities,"[162] interest income from state and local government bonds,[163] international organizations and foreign government employees' income,[164] and certain investment

[158] The exemption covers $1.5 trillion in economic activity. *See* U.S. BUREAU OF ECON. ANALYSIS, *supra* note 28. A crude estimation of revenue using an average tax rate of 13% would yield $195 billion. The EITC (around $70 billion) and the CTC (around $120 billion) cost a combined $190 billion in 2023. *See* STAFF OF JOINT COMM. ON TAX'N, 117TH CONG., JCX-22-22, ESTIMATE OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2022–2026, at 40–41 tbl.1 (Comm. Print 2022).

[159] *See generally* Cynthia L. Krom & Stephanie Krom, *The Whiskey Tax of 1791 and the Consequent Insurrection: "A Wicked and Happy Tumult,"* 40 ACCT. HISTORIANS J. 91 (2013) (describing the Whiskey Rebellion as one over the ability of the federal government to levy an income tax).

[160] 17 U.S. (4 Wheat.) 316 (1819).

[161] The exemption for foreign governments, for example, can be traced to the origins of the income tax, with a provision first enacted in 1917. *See* War Revenue Act of 1917, Pub. L. No. 65-50, § 1211, 40 Stat. 300, 337 (adding § 30, exempting foreign governments' investment and interest income from tax, to the Revenue Act of 1916, Pub. L. No. 64-271, 39 Stat. 756). Despite changes to some of its contours (e.g., clarifying that central banks are exempt even if separately incorporated, exempting for sovereign wealth funds, or disallowing an exemption for commercial activities of foreign governments), the exemption has been relatively stable for almost a century.

[162] *See* Davis v. Mich. Dep't of the Treasury, 489 U.S. 803, 811 (1989) ("After *Graves*, therefore, intergovernmental tax immunity barred only those taxes that were *imposed directly on one sovereign by the other* or that discriminated against a sovereign or those with whom it dealt." (emphasis added)).

[163] I.R.C. § 103.

[164] *See id.* § 893.

income earned by foreign governments,[165] international organizations,[166] and sovereign wealth funds (SWFs).[167] As such, we can think of three different categories of exemptions: (1) exemptions for foreign governments and their operations, agents, and investments; (2) exemptions for international organizations and their operations, agents, and investments; and (3) exemptions for domestic, nonfederal (i.e., state, local, and Indian nation) governments and their operations, agents, and investments.

The United States is not an outlier in exempting these sorts of activities.[168] For example, countries uniformly exempt diplomatic and consular missions from all sorts of taxes,[169] such as income and social security taxes on the diplomatic mission's workers[170] and activities,[171] property taxes on the mission's property,[172] and taxes on the transfer of goods for the "official use" of the mission and "personal use" of diplomatic agents from some indirect taxes (e.g., sales and use taxes).[173] In addition, international organizations and their employees benefit from "the most universal tax exemption afforded to members of the international

[165] *See, e.g.*, *id.* § 892(a)(1) (exempting foreign government income from investments in "stocks, bonds, or other domestic securities owned by such foreign governments," from financial instruments held in the execution of governmental financial or monetary policy, and from interest on deposits in U.S. banks). If such investment income is "derived [in connection to] the conduct of any commercial activit[ies]," however, then such income would not be generally exempt. *See id.* § 892(a)(2).

[166] *See id.* § 892(b).

[167] *See* Treas. Reg. § 1.892-2T(a)(1), (a)(3), (c) (2023) (exempting certain investment income earned by "controlled entities" of a foreign government, including by a foreign government's pension trusts). Congress has enacted other provisions to exempt from taxation and withholding certain types of other income, such as income from the sale of certain interests in U.S. real property under the Federal Investment in Real Property Tax Act (FIRPTA). *See* I.R.C. § 897(l) (carving out income that would otherwise be taxable under FIRPTA if such income is earned by a "qualified foreign pension fund"). Recently enacted regulations sought to expansively read what qualified for the exemption, as the Treasury and the IRS believed the exemption's "purpose" was "best served by permitting a broad range of structures to be treated as" eligible. *See* T.D. 9971, 2023-3 I.R.B. 346–72.

[168] *See* Maliká Khushmatova, *Limited Tax Immunity: International Nongovernmental Organizations and States*, 114 TAX NOTES INT'L 1041, 1041–43 (2024) (surveying international views on tax immunity for other states and international nongovernmental organizations). As Khushmatova notes, the United States' approach to limited tax immunity is also present in other countries worldwide. *Id.*

[169] Vienna Convention on Diplomatic Relations and Optional Protocol Concerning the Compulsory Settlement of Disputes, art. 23, Apr. 18, 1961, 23 U.S.T. 3227, 3238, 500 U.N.T.S. 95 [hereinafter VCDR]; *see also* Vienna Convention on Consular Relations, art. 32, Apr. 24, 1963, 21 U.S.T. 77, 98, 596 U.N.T.S. 261 (extending the treatment to consular missions); Convention on Special Missions, art. 24, Dec. 8, 1969, 1400 U.N.T.S. 231 (extending the treatment to special missions).

[170] *See* VCDR, *supra* note 169, arts. 33–34.

[171] *See id.* art. 28.

[172] *See id.* art. 23.

[173] *See id.* art. 36.

community."[174] Host countries also generally exempt other direct governmental activities, such as development assistance.[175]

2. *Comity, Federalism, and the Exemption of Other Sovereigns*

But why do governments enact such exemptions? Commentators have generally presumed that these exemptions are worthwhile subsidies. Enter the Subsidy Theories, with the unenviable job of explaining the current state of the law. It is admittedly odd to "subsidize" the activities of a foreign sovereign from one's own fisc. But theories that envisage exemptions simply as subsidies could plausibly use consonant law-and-economics and realist rationales to explain this result.[176] Drawing on explanatory frameworks from international law, subsidy theories could argue that the exemptions are nothing less than a result dictated by game theory dynamics among competing States, where parties strategically converge or cooperate on the taxation of one another to avoid the deadweight loss that would otherwise arise from each sovereign taxing one another. In other words, sovereigns merely seek to avoid costly taxes on each other's operations and have therefore converged in a coordinated and uniform approach to avoid taxation.[177]

Certain features of the exemption regime indeed support reading the exemption regime as one of strategic subsidies. For example, some exemptions require reciprocity, suggesting that strategic optimizing behavior is in play: if a foreign government would not exempt the U.S. government on an item of income, then such a government would not be exempt from

---

[174] *See* Jon Taylor, *Tax Treatment of Income of Foreign Governments and International Organizations*, *in* 3 DEP'T OF THE TREASURY, ESSAYS IN INTERNATIONAL TAXATION: 1976, at 151, 154 (1976).

[175] *See* OECD, TAX AND DEVELOPMENT AT THE OECD: A RETROSPECTIVE 2009–2024, at 39 (2023). That said, it is unclear whether the exemption of official development assistance enhances welfare or revenue, especially from the perspective of recipient countries. *See* ÉMILIE CALDEIRA, ANNE-MARIE GEORUJON & GRÉGOIRE ROTA-GRAZIOSI, FERDI, THE PARADOX OF TAX EXEMPTIONS OF OFFICIAL DEVELOPMENT ASSISTANCE IN DEVELOPING COUNTRIES (2018), https://ferdi.fr/dl/df-cxBzbQUkr32DYsEdssMeM4c1/ferdi-b172-the-paradox-of-tax-exemptions-of-official-development-assistance.pdf [https://perma.cc/W3UP-X88Z].

[176] Professors Eric Posner and Jack Goldsmith's work on international law, specifically customary international law, provides a likely blueprint for these arguments. *See generally* JACK L. GOLDSMITH & ERIC A. POSNER, THE LIMITS OF INTERNATIONAL LAW (2006) (developing a realist account of international law).

[177] Many tax scholars have analyzed these exemptions through this lens. For example, Professor Victor Fleischer vigorously attacks the exemption of investment income by sovereign wealth funds as an inefficient subsidy—with passing attention given to other norms that might otherwise justify the exemption. *See* Fleischer, *supra* note 79.

U.S. taxation.[178] That is the case, for example, for the income tax exemption for a foreign government's nonconsular workers, which applies only to the extent the foreign government grants an equivalent exemption to U.S. workers performing similar services.[179] Such exemptions lend preliminary credence to the notion that the regime results from strategic behavior among sovereigns, with some sovereigns arriving at an equilibrium of mutually beneficial reciprocal exemptions.[180]

The reality, however, is far more complicated and betrays the simple narrative that Subsidy Theories would proffer. First, some exemptions in the U.S. regime (perhaps most controversially, the exemption for SWF's investment income) are general and do not require reciprocity, suggesting that other considerations must be at play to justify their existence.[181] (Commonwealth countries, sharing similar common law principles, generally provide exemptions for SWFs.)[182] A lack of reciprocity is generally inconsistent with theories that explain the sovereign exemptions as mere subsidies or as the pure result of strategic behavior—after all, why give out a "subsidy" without requiring one in return if getting one is feasible?[183]

---

[178] *See, e.g.*, I.R.C. § 893(a) (excluding income earned by non-U.S. citizens working for a foreign government if such foreign government would reciprocally grant an equivalent exemption to a U.S. government employee performing similar services in such foreign state). Recent policy proposals by Senator Wyden would similarly (partly) condition exemptions for sovereign wealth funds on the existence of reciprocal trade agreements. *See* Ending Tax Breaks for Massive Sovereign Wealth Funds Act, S. 2518, 118th Cong. (2023); *see also* Fleischer, *supra* note 79, at 447 (arguing for a repeal of the United States' blanket exemption of investment income by sovereign wealth funds, and arguing that "[a]t a minimum, the tax exemption should be offered only if reciprocal treatment is offered for U.S. funds, such as state pension funds and Alaska's Permanent Fund").

[179] I.R.C. § 893(a).

[180] *See* Taylor, *supra* note 174, at 158 (noting that countries that provide exemptions for sovereign wealth funds do so "on a reciprocal basis only"). *But see* JCT SWF REPORT, *supra* note 1, at 77–78 (rebutting that claim).

[181] *See* Fleischer, *supra* note 79, at 445 (acknowledging—begrudgingly—that under the current § 892, the U.S. tax regime "unilaterally treat[s] [sovereign wealth funds] as sovereigns acting to further political, diplomatic, or humanitarian agendas, and we therefore exempt them from taxation as if it were a matter of international comity"); JCT SWF REPORT, *supra* note 1, at 77–78 (noting that, out of eight representative foreign jurisdictions surveyed, four provide a general exemption for sovereign wealth funds, and two more do so on a reciprocal basis).

[182] JCT SWF REPORT, *supra* note 1, at 77.

[183] Some might offer an alternative justification: the SWF exemption from withholding taxes is a subsidy intended to incentivize SWFs to invest in certain sectors (namely, real estate). A reciprocal subsidy would be ideal, but that does not mean that an unreciprocated subsidy to SWFs is not in the United States' interests. This alternative justification also fails: It is unclear how an exemption for withholding taxes on certain types of SWF's investment income affects their investment decisions and incentivizes certain investments, so it is far from obvious that exempting these investments constitutes a "subsidy." Professor Michael Knoll's rigorous exploration of whether the "preference" given to certain

Second, it is unclear whether Subsidy Theories succeed on their own terms because the current regime is not evidently optimal (or even oriented towards optimizing). As both Musgravian tax scholars and political scientists would suspect, there are real (and constant) incentives for sovereigns to expand their tax jurisdiction to include the operations of other sovereigns—especially where there are power imbalances that make these optimal equilibria not only unstable but also unlikely in the first place. "Don't tax me; don't tax thee; tax the fellow behind the tree," the common tax saying goes.[184] If the United States can convince other sovereigns to grant it an exemption without reciprocating—likely given the United States' still-hegemonic position and its relative success in carving out sweet deals for itself in other areas of the tax law[185]—then how could it offer an exemption guided solely by relentless economic realism?

Third, the Subsidy Theory applies only to a *subset* of a wide range of sovereign exemptions (generally, a couple of provisions regarding the coordinated exemption of income from foreign governments and SWFs), suggesting that, at best, the theory has only partial explanatory power, and, at worst, it mistakes the forest for the trees. For example, a law-and-economics subsidy theory cannot readily explain why the United States would grant an exemption to international organizations and their workers,[186] a significant and "universal" practice.[187]

---

investments by SWFs empirically results in SWFs having a "tax advantage" over certain other investors (e.g., vis-à-vis private foreign investors, private domestic investors) for certain investments highlights how the effects from these preferences are far from straightforward. *See* Michael S. Knoll, *Taxation and the Competitiveness of Sovereign Wealth Funds: Do Taxes Encourage Sovereign Wealth Funds to Invest in the United States?*, 82 S. CAL. L. REV. 703 (2009). Add to that the historical lineage of the SWF exemption, *see infra* notes 195–203 and accompanying text, and this alternative explanation for the SWF exemption becomes quite implausible.

184 *See supra* notes 31–35 and accompanying text. *See generally Don't Tax You. Don't Tax Me. Tax that Fellow Behind the Tree*, QUOTE INVESTIGATOR (Apr. 4, 2014), https://quoteinvestigator.com/2014/04/04/tax-tree/ [https://perma.cc/H9V8-9T9C] (providing the history behind the infamous quote).

185 *See, e.g.*, Luis Calderon Gomez, Note, *Transcending "Tax" Sovereignty and Tax Standardization: Three Questions*, 45 YALE J. INT'L L. 192, 213–17 (2020) (discussing the United States' success in creating a unilateral information-exchange regime).

186 One might try to tweak the Subsidy Theory to accommodate this exemption, seeing the exemption as Congress's way of incentivizing the work of international organizations, especially because the United States is often a significant donor to these organizations. In other words, why take it from one pocket to put it in the other? This articulation, however, is a logical and factual stretch. First, not all international organizations receive funding from the United States, and a rare few receive 100% therefrom. As a result, some revenue is left on the table by exempting international organizations and their workers. (The marginal administrative costs of taxing international organizations are unlikely to be significantly higher than the administrative costs of administering the exemption). Second, the exemption is a rather inefficient way to subsidize these organizations vis-à-vis more direct funding, for example, as the exemptions are likely to create economic distortions.

187 *See* Taylor, *supra* note 174, at 157.

Furthermore, the exemptions currently awarded to state and local governments are puzzling from a subsidy perspective and are an implausible result of strategic behavior. On the one hand, the exemptions for state and local governments are much more expansive than the ones offered to foreign governments,[188] despite (i) the indisputably superior ability of foreign governments to retaliate against the U.S. federal government's tax policies, which would presumably dictate laxer taxation of foreign governments, and (ii) the federal government's structural legal supremacy over state and local governments.[189] (Moreover, the federal government's consent to state and local government taxation of federal employees further complicates a simple reading of these dynamics from a realist strategic perspective.)[190] On the other hand, state and local governments *do* provide services that might substitute for federal government services, which would seem to merit a more generous exemption. But the exemption is not tailored to reach those substitutable services, as services that would not be provided (and in fact might even contravene federal policies) are subsidized just as much as services that the federal government would provide.[191] Thus, Subsidy Theories—in their realist law-and-economics personification—fail as a comprehensive or even plausible account of the exemption for other sovereigns.

As the Limits Theory evidences, Subsidy Theories' struggles to rationalize the exemption are not inevitable. The sovereign exemptions are best seen as a downstream result of deep and widespread non-tax considerations about how public spheres (in this case, sovereigns) relate to each other—captured by concepts such as comity, sovereign immunity, and federalism. Such sociopolitical judgments about the treatment of other public spheres can be traced back to Vattel's early foundational writings on international law[192] and remain present in modern political philosophy,

[188] *See, e.g.*, STAFF OF JOINT COMM. ON TAX'N, *supra* note 1, at 52 ("The limited U.S. income tax exception afforded foreign governments and foreign central banks of issue under sections 892 and 895 is significantly less favorable than the U.S. income tax treatment afforded nonfederal sovereigns, specifically U.S. States and Indian tribes.").

[189] *See* McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819).

[190] 4 U.S.C. § 111(a).

[191] For example, several states provide benefits to undocumented immigrants in contravention of stated federal policy. For a helpful summary, see Tanya Broader & Gabrielle Lessard, *Overview of Immigrant Eligibility for Federal Programs*, NAT'L IMMIGR. L. CTR. (May 2024), https://www.nilc.org/issues/economic-support/overview-immeligfedprograms/ [https://perma.cc/ZK7Q-XHYY]. Professor Peter Markowitz has framed such state policies as part of a broader effort to challenge the federal government by providing state citizenship to undocumented individuals to whom the federal government will not provide federal citizenship. *See* Peter Markowitz, *Undocumented No More: The Power of State Citizenship*, 67 STAN. L. REV. 869, 902–15 (2015).

[192] VATTEL, *supra* note 102, at 281.

whether it be Rawls,[193] Michael Walzer,[194] or Nozick.[195] Critically, these widespread notions place other sovereigns (given their condition as separate public spheres) outside the public sphere in question and consequently outside the scope of ordinary taxation, justifying the exemption and explaining its legal contours.

The connection between the notions of comity and sovereign immunity and the sovereign exemptions is apparent from the exemption's historical and legal development. Consider the foreign sovereigns' exemptions. Our international legal system is grounded on the longstanding post-Westphalian international law principle that sovereigns cannot ordinarily subject other sovereigns to their own laws, at least without their consent.[196] This broad and undisputed foundational principle—expressed in terms of "comity"[197] or "sovereign immunity,"[198] depending on the context—provided the starting point for the exemptions for foreign governments, their activities, and their agents.[199] In a report to Congress, the Joint Committee on Taxation put it quite succinctly: the regime was a "natural extension" of their sovereign

---

[193] RAWLS, *supra* note 88, at 331–32 (finding that the "principle of equality" of nations would be arrived at by applying the original-position construct to nations).

[194] *Cf.* MICHAEL WALZER, SPHERES OF JUSTICE: A DEFENSE OF PLURALISM AND EQUALITY 61–63 (1983) (discussing the limits of membership in a community and how the spheres of justice are to be understood as delineated by membership in a specific community).

[195] *Cf.* NOZICK, *supra* note 89, at 325–34 (describing coexisting communities operating on equal footing as part of his utopia framework).

[196] The principle of sovereign immunity has its roots in the U.S. domestic legal system from the seminal decision of *Schooner Exchange v. McFaddon*, 11 U.S (7 Cranch) 116, 137 (1812). The Restatement summarizes: "While there have been relations between 'states' since early human history, and some law governing those relations, modern international law is commonly dated from the Peace of Westphalia (1648) and the rise of the secular state . . . . Modern international law is rooted in acceptance by states which constitute the system." RESTATEMENT (THIRD) OF FOREIGN RELS. L. pt. I, ch. 1, intro. note (AM. L. INST. 1987).

[197] *See, e.g.*, F. Hoffmann–La Roche Ltd. v. Empagran S.A., 542 U.S. 155, 164 (2004) (characterizing "international comity" as "avoid[ing] unreasonable interference with the sovereign authority of other nations"); Spector v. Norwegian Cruise Line Ltd., 545 U.S. 119, 130 (2005) (plurality opinion) (declining to extend the "comity" principle to a foreign cruise ship in U.S. waters); Dodge, *supra* note 103 (developing a comprehensive account of comity in U.S. domestic law and arguing that significant domestic doctrines are traceable to the notion of comity).

[198] *See, e.g.*, *Schooner Exch.*, 11 U.S. (7 Cranch) at 146.

[199] For an exploration of this development from a comparative perspective, see Wm. W. Bishop Jr., *Immunity from Taxation of Foreign State-Owned Property*, 46 AM. J. INT'L L. 239 (1952).

immunity from U.S. courts.[200] Scholars[201] and practitioners,[202] even ones skeptical of the exemption,[203] agree on these origins.

The exemptions for subnational governments can be analogously traced to similar notions of comity and federalism that intuitively place these subnational governments outside of the public sphere and thus the scope of ordinary income taxation. This is not surprising: After all, constitutional scholars have convincingly argued that principles of federalism originated from international law principles such as comity.[204]

Although by now substantially curtailed,[205] concerns about comity and federalism undergirded the intergovernmental tax immunity doctrine, which once barred the taxation of one sovereign by another. Nowhere are these concerns clearer than in *McCulloch v. Maryland*, the genesis for the law's current exemption of subnational sovereigns, which even uses the language of sovereignty and separate spheres to describe tax's limits. In *McCulloch*, Chief Justice Marshall reasoned that state governments could not tax the federal government because "[i]t is of the very essence of supremacy to remove all obstacles to [the federal government's] action *within its own sphere*, and so to modify every power vested in subordinate governments, as to exempt its own operations from their own influence."[206] As such, the separation of the spheres—between state and federal government—required that the federal government be exempt from state taxation.

The Court quickly expanded *McCulloch*'s cosmology of separate sovereignty to other areas of federal operations,[207] such as the ability of

---

200 *See* STAFF OF JOINT COMM. ON TAX'N, *supra* note 1, at 73.

201 *See, e.g.*, Mihir A. Desai & Dhammika Dharmapala, *Taxing the Bandit Kings*, 118 YALE L.J. POCKET PT. 98, 99 (2008); David R. Tillinghast, *Sovereign Immunity from the Tax Collector: United States Income Taxation of Foreign Governments and International Organizations*, 10 LAW & POL'Y INT'L BUS. 495, 496 (1978); Bishop, *supra* note 199.

202 *See* N.Y. STATE BAR ASS'N TAX SECTION, REPORT ON THE TAX EXEMPTION FOR FOREIGN SOVEREIGNS UNDER SECTION 892 OF THE INTERNAL REVENUE CODE 3 (2008), https://nysba.org/app/uploads/2020/03/1157-Report.pdf [https://perma.cc/NR99-FY8H] ("Section 892 reflects an extension to the Code of the longstanding common law doctrine of 'sovereign immunity'—that is, the doctrine that sovereign governments generally should not be subject to each other's jurisdiction in respect of state activities."); BABAK E. NIKRAVESH, BLOOMBERG TAX, PORTFOLIO 6520-1ST: U.S. INCOME TAXATION OF FOREIGN GOVERNMENTS, INTERNATIONAL ORGANIZATIONS, CENTRAL BANKS, AND THEIR EMPLOYEES § I.A (2023).

203 *See* Fleischer, *supra* note 79, at 456.

204 *See* Bellia & Clark, *supra* note 103.

205 *See* Davis v. Mich. Dep't of the Treasury, 489 U.S. 803, 811 (1989) ("After *Graves*, therefore, intergovernmental tax immunity barred only those taxes that were imposed directly on one sovereign by the other or that discriminated against a sovereign or those with whom it dealt.").

206 17 U.S. (4 Wheat.) 316, 427 (1819) (emphasis added).

207 *See, e.g.*, Weston v. City Council, 27 U.S. (2 Pet.) 449, 469 (1829) (expanding *McCulloch* to include government stock).

states to tax federal employees' offices. In *Dobbins v. Commissioners of Erie County*, the Court stated that

> [t]he only difficulty in the [state tax] act has arisen from the terms directing assessments to be made upon all offices and posts of profit, without restricting the assessments to offices and posts of profit held under the sovereignty of that state; and not excluding them from being made upon offices and posts of profit of another sovereignty—the United States.[208]

Such conception of separate sovereignty, combined with respect for the supremacy of the United States, required that the states refrain from taxing employees of the United States.[209]

The Court extended *McCulloch*'s limited exemption for upward taxation (i.e., subnational taxation of the federal government) to "downward" taxation in *Collector v. Day*. In *Day*, the Court acknowledged that "no express provision in the Constitution . . . prohibits the general government from taxing the means and instrumentalities of the States, nor is there any prohibiting the States from taxing the means and instrumentalities of that government."[210] The majority appealed to symmetrical treatment between the state and the federal government, however, reasoning that "[i]n both cases the exemption rests upon necessary implication, and is upheld by the great law of self-preservation; as any government, whose means employed in conducting its operations, if subject to the control of another and distinct government, can exist only at the mercy of that government."[211] Drawing upon language and imagery reminiscent of the Limits Theory, the Court reasoned that despite the lack of an explicit constitutional prohibition on downward taxation, "the necessary existence of the States, and *within their proper spheres*, the independent authority of the States" required that, as a structural matter, states enjoy exemption from federal taxation.[212]

The exemption for subnational governments was then incorporated into the early federal income tax in its pre-[213] and post-*Pollock* incarnations.[214]

---

[208] Dobbins v. Comm'rs of Erie Cnty., 41 U.S. (16 Pet.) 435, 447 (1842), *overruled in part on other grounds by* North Dakota v. United States, 495 U.S. 423 (1990).

[209] *Id.* at 449.

[210] 78 U.S. (11 Wall.) 113, 127 (1871), *overruled by* Graves v. New York *ex rel.* O'Keefe, 306 U.S. 466 (1939).

[211] *Id.*

[212] *Id.* at 125 (emphasis added) (quoting Lane Cnty. v. Oregon, 74 U.S. (7 Wall.) 71, 76 (1869)).

[213] *See, e.g.*, Wilson–Gorman Tariff Act, ch. 349, § 32, 28 Stat. 509, 556 (1894) ("[N]othing herein contained [regarding the new 2% income tax imposed by the Act] shall apply to States, counties, or municipalities.").

[214] *See* Revenue Act of 1913, ch. 16, § II(G)(a), 38 Stat. 114, 172 (1913) ("That there shall not be taxed under this section any income derived from any public utility or from the exercise of any essential

At the time, the exemption theoretically applied to the compensation of state and local officers and employees, significantly expanding the exemption's scope.[215] Several post-*Lochner* Court decisions substantially curtailed the exemption,[216] with a special focus on ending the roundly criticized exemption for state and local officers and employees.[217] Congress quickly amended the Code to clarify that state employees should be subject to federal taxation, with the Senate Report succinctly opining that "[t]he taxpayers are citizens of the United States, and bound to contribute to its support."[218]

The current scope of the doctrine was set in two late-1980s decisions: *South Carolina v. Baker* and *Davis v. Michigan Department of the Treasury*. In *Baker*, the Court recounted the historical decline of the intergovernmental tax immunities doctrine, noting that the expansive reasoning of *Pollock*-era cases had been "thoroughly repudiated."[219] This repudiation meant that a general tax would not be unconstitutional merely because its imposition on private parties, in effect, burdened the government.[220] "In sum," the Court concluded,

> under current intergovernmental tax immunity doctrine the States can never tax the United States directly but can tax any private parties with whom it does business, even though the financial burden falls on the United States, as long as the tax does not discriminate against the United States or those with whom it deals.[221]

The Court thereby held that the intergovernmental tax immunities did not bar the federal government from enacting a general and nondiscriminatory income tax on the interest on state and local bonds.[222]

---

governmental function accruing to any State, Territory, or the District of Columbia . . . ."). The law currently exempts such income through the intergovernmental tax immunities doctrine and § 115, which exempts certain state activities conducted through separate entities. I.R.C. § 115 (2024); I.R.S. Priv. Ltr. Rul. 200210024 (Aug. 3, 2002) (rehearsing the IRS's interpretation of the exemption).

[215] *See* Revenue Act of 1913, ch. 16, § II(B), 38 Stat. 168; 53 CONG. REC. 13262–63 (1916) (statement by Sen. John Williams) ("[The exemption for the compensation of officers and employees of States] is because of the principle announced in the case of McCulloch against Maryland, where it was said that one of these two dual sovereignties of ours could not tax the agencies or instrumentalities of the other, because, if it could, it could tax them out of existence and destroy them.").

[216] Graves v. New York *ex rel.* O'Keefe, 306 U.S. 466, 486 (1939); Helvering v. Gerhardt, 304 U.S. 405, 423 (1938).

[217] *See, e.g.*, Roswell Magill, *Tax Exemption of State Employees*, 35 YALE L.J. 956, 966–67 (1926) (discussing the "evils of exemptions" and arguing against the imposition of exemptions for state employees whether by judge or legislators).

[218] S. REP. NO. 112, at 7 (1939).

[219] 485 U.S. 505, 520 (1988).

[220] *Id.* at 521–22.

[221] *Id.* at 523.

[222] *Id.* at 527.

Briefly tracing the history of the exemption reveals the redrawing of its contours over time, in line with the evolution of sociopolitical judgments regarding the relationship between federal and subnational governments—from *McCulloch*'s concern about the supremacy of the federal government, to *Day*'s concern about federalism, to *Graves*'s reevaluation after *Lochner* was abandoned, and beyond. Yet even in the decisions where the Court cabined the exemption, it discusses the exemption's limits in the language of comity and federalism, highlighting the inextricable role of these concepts in explaining and justifying the exemption.[223]

Unlike the Subsidy Theory, the Limits Theory can explain why the sovereign exemptions apply in various contexts—even though the economic and political considerations in these contexts would imply different regimes. Common normative concerns about comity explain how the exemption covers all kinds of sovereigns relatively uniformly—from states and localities to Indian nations, foreign sovereigns, and international organizations—despite vastly different strategic relationships. Moreover, even setting aside its incompleteness, the Subsidy Theory cannot convincingly explain the rationale behind some of the law's contours—e.g., why the exemption is provided to international organizations, why the exemption is uniformly more generous to subnational governments than to foreign ones, and why the exemptions do not require reciprocity. Exposing the sociopolitical judgments (and context) underlying the exemptions hints that the answers to these questions should relate to the degree of comity that one sovereign is due by another under our prevailing sociopolitical and legal understandings.

The Limits Theory is also superior from a normative perspective. It is not evident why welfare or revenue optimization should reign supreme in structuring the taxation relationship among sovereigns—especially when the rules governing these inter-sovereign relationships are multi-faceted, pluralistic, and often complex. Unlike a Subsidy Theory, the Limits Theory connects the rules governing taxation of one sovereign by another with broader normative and legal constructs underpinning these relationships—e.g., comity and federalism—rendering them both more intelligible and justifiable from a normative perspective. In other words, the rules go from being discrete, contextless tax policy decisions about, for example, whether

[223] *See, e.g.*, Davis v. Mich. Dep't of the Treasury, 489 U.S. 803, 814 (1989) ("It is true that intergovernmental tax immunity is based on the need to protect each sovereign's governmental operations from undue interference by the other."); *Baker*, 485 U.S. at 512 ("*Garcia* holds that the limits are structural, not substantive—*i.e.*, that States must find their protection from congressional regulation through the national political process, not through judicially defined spheres of unregulable state activity." (citing *Garcia v. Metro. Transit Auth.*, 469 U.S. 528, 537–54 (1985))).

foreign government employees should be exempt from federal income taxation, to being instantiations of broader judgments about comity, the ability of states to interfere with one another in their official capacity, and neutrality in international law. Similarly, the rules on taxation of foreign governments are recast from decisions about the mere economic efficacy or administrability to instantiations of broader, evolving pseudo-constitutional judgments about the proper relations of states in the international legal order.

C. Charities

1. The Law

Another critical tax limit is the charitable sphere. Charities are generally exempt from U.S. federal income taxation. A wide array of provisions in the Code accomplish this result. Organizations colloquially understood as charities (a category that includes churches) qualify for the exemption under § 501(c)(3).[224] The charitable exemption has been a constant feature of the income tax—dating back to its premodern version in the Wilson Tariff Act before the passage of the Sixteenth Amendment.[225]

To qualify for a tax exemption as a § 501(c)(3) organization—the most significant category of tax-exempt nonprofits, encompassing around two-thirds of exempt organizations[226]—an organization must meet several requirements.[227] First, the organization must be organized *and* operated exclusively for exempt purposes. Exempt purposes include religious, charitable, scientific, public-safety, literary, educational, or animal- or child-welfare-related purposes.[228] Second, the organization's earnings must not inure to any private shareholder or individual.[229] The regulations state that

[224] Other sections provide for the nontaxation of a quixotic variety of nonprofit organizations, from social welfare organizations, unions, social clubs, and fraternal organizations to certain cemeteries. *See* I.R.C. § 501(c)(4) *et seq.* I use the term "nontaxation" to distinguish it from exemption as used in this Article because some of these organizations (e.g., social clubs and fraternal organizations) arguably lack income. *See infra* notes 250–251 and accompanying text (discussing Bittker's measurement theory).

[225] Wilson–Gorman Tariff Act, ch. 349, § 32, 28 Stat. 509, 556 (1894). After passing the Sixteenth Amendment, Congress reenacted these exemptions in the first modern Code in 1913. *See* Revenue Act of 1913, ch. 16, § II(G)(a), 38 Stat. 114, 172 (1913); 50 CONG. REC. 509 (1913) (statement by Rep. Cordell Hull) (describing the bill's extension of the previous exemption for nonprofit organizations).

[226] Around 66% of tax-exempt organizations of this kind are § 501(c)(3) charitable organizations, with this share steadily increasing. *See* JCT CHARITIES REPORT, *supra* note 24, at 19 (calculating the share as a percentage of total tax-exempt organizations in 2004).

[227] These requirements have long been part of the exemption and thus are essential to understanding its contours and rationale. *See* Payne–Aldrich Act, ch. 6, § 38, 36 Stat. 11, 113 (1909).

[228] Treas. Reg. § 1.501(c)(3)-1(d)(1)(i).

[229] *See* I.R.C. § 501(c)(3). The regulations also provide that organizations whose "net earnings inure in whole or in part to the benefit of private shareholders or individuals"—a bar slightly higher but related

the organization must "serve[] a public rather than a private interest."[230] Third, the organization must not engage in political activities to a substantial degree.[231] Fourth, the organization must not violate public policy.[232]

But the charitable exemption regime is not only composed of an income exemption to the organization in question. Section 170 provides for a deduction for "any charitable contribution."[233] The Code defines a charitable contribution as a "contribution or gift" of money or property to or for the use of (i) the United States, a state, a possession of the United States, or any of their political subdivisions, but only if made for exclusively public purposes;[234] (ii) certain veterans' organizations;[235] (iii) certain fraternal organizations, if the gift is for charitable, scientific, literary, educational purposes, or for the prevention of cruelty to children or animals;[236] (iv) certain cemeteries operated not for profit;[237] and—most importantly—(v) certain U.S. charitable organizations.

To qualify for the deduction, the charity must be organized in the United States,[238] and—largely mirroring the language from the exemption under § 501(c)(3)—the entity must be "organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition . . . or for the prevention of cruelty to children or animals."[239] Moreover, eligible organizations must also ensure that no part of their net earnings inures to the benefit of a private individual[240] and that it complies with the limits on political activities imposed by § 501(c)(3).[241] Lastly, charitable organizations must generally use deductible contributions *within* the United States or its

to the "no private inurement" requirement—will fail the operational test and lose their tax exemption. *See* Treas. Reg. § 1.501(c)(3)-1(c)(2); Rameses Sch. of San Antonio v. Comm'r, 93 T.C.M. (CCH) 1092, 1095 (2007) ("If an organization can be shown to benefit private interests, a limitation substantially overlapping but encompassing more than simply the inurement of earnings to insiders, it will be deemed to further a nonexempt purpose.").

230 Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii).

231 *See* I.R.C. § 501(c)(3); *see also* Treas. Reg. § 1.501(c)(3)-1(c)(3) (specifying that an organization engaging in these political activities fails the operational test under the regulations).

232 *See* Bob Jones Univ. v. United States, 461 U.S. 574, 585–92 (1983).

233 I.R.C. § 170(a).

234 *Id.* § 170(c)(1).

235 *Id.* § 170(c)(3).

236 *Id.* § 170(c)(4).

237 *Id.* § 170(c)(5).

238 *Id.* § 170(c)(2)(A). A slight wrinkle: U.S. income tax treaties allow a deduction for charitable contributions to certain Mexican, Canadian, and Israeli charitable organizations. *See* INTERNAL REV. SERV., PUBL'N 526, CHARITABLE CONTRIBUTIONS 3 (2024).

239 I.R.C. § 170(c)(2)(B).

240 *Id.* § 170(c)(2)(C).

241 *Id.* § 170(c)(2)(D).

possessions,[242] thus banning direct contributions to foreign charities[243] and largely restricting the deductibility of contributions for use outside the United States.[244]

As the statutory language makes evident, the charitable contribution regime largely mirrors the charitable tax exemption. Both regimes impose almost identical restrictions on the types of purposes and activities that organizations must have to receive favorable treatment.[245] Moreover, both regimes impose identical restrictions on political activities[246] and bar private inurement.[247] Additional restrictions on an organization seeking to qualify for a tax exemption—for example, requiring an organization to follow public policy[248]—similarly apply to organizations seeking to become eligible donees for a deductible contribution.[249] As a result, these two provisions, though not identical, are substantially coterminous and constitute parts of the same regime.[250]

2. Public Benefit, Autonomy, and the Charitable Exemption Regime

Despite the charitable regime's salience in the public imagination and attraction of the most scholarly attention, no widely accepted "unifying theme or singular principle" has convincingly justified the existence and explained the contours of the charitable exemption regime.[251]

A strand of theories put forth to explain the charitable regime are "Base Theories," which argue that tax exemptions should not be understood

242 *See id.* § 170(c)(2); Rev. Rul. 63-252, 1963-2 C.B. 101.

243 The prohibition also applies to domestic organizations acting as conduits for foreign charities. *See* Rev. Rul. 63-252, 1963-2 C.B. 101, 103–05.

244 Contributions can still generate benefits outside of the United States; however, the domestic charitable organization must exercise real control over funds designated to eventually provide benefits outside of the United States. *See id.* at 101.

245 *Compare* I.R.C. § 170(c)(2)(B), *with id.* § 501(c)(3) (providing nearly identical restrictions, except for an additional exemption for organizations "testing for public safety").

246 *See* I.R.C. § 170(c)(2)(D) (pointing to the restriction in I.R.C. § 501(c)(3)).

247 *Compare id.* § 170(c)(2)(C), *with id.* § 501(c)(3) (providing an identical prohibition).

248 *See, e.g.*, Rev. Rul. 71-447, 1971-2 C.B. 23 (rejecting a school's exemption and eligibility for deductible charitable contributions due to its racially discriminatory policies).

249 The public policy requirement applies to charities broadly. *See id.*

250 As Professor William Andrews argues, moreover, the charitable deduction is better understood as a tax-base limit rather than a subsidy or tax expenditure for certain types of favored consumption. *See* William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309, 314–15, 344–51 (1972).

The Supreme Court has often treated them together. *See, e.g.*, Regan v. Tax'n with Representation of Wash., 461 U.S. 540, 544 (1983) ("Both tax exemptions and tax deductibility are a form of subsidy that is administered through the tax system. A tax exemption has much the same effect as a cash grant to the organization of the amount of tax it would have to pay on its income. Deductible contributions are similar to cash grants of the amount of a portion of the individual's contributions.").

251 *See* JCT CHARITIES REPORT, *supra* note 24, at 3.

as intentional departures from a normal baseline of taxation; rather, exemptions are properly understood as a mere result of applying proper tax principles.[252] So, according to Professor Boris Bittker—the proponent of the most prominent Base Theory—charitable organizations are exempt from the federal income tax because they do not have "income" in any meaningful sense.[253] After all, the organizations are subject to nondistribution constraints and liquidation rules to ensure that all retained earnings are spent eventually. Others argue that instead, the exemption is a result of sovereignty: A proper federal income tax levied by a sovereign government cannot subject other sovereigns, such as churches, to tax.[254] These theories, however, have been largely abandoned given their inability to offer a minimally accurate descriptive account of the current exemption regime—a regime exempting both organizations that have significant income from both service fees and investments and that seem unlikely to spend retained earnings anytime soon; such organizations include Yale University and the Mayo Clinic, as well as organizations far removed from any lofty aspirations to sovereignty, such as PETA or Meals on Wheels.

As we have seen, the dominant strand of the literature—the Subsidy Theories—has sought to explain exemptions not as principled tax regimes but as intentional subsidies awarded by the State.[255] Traditionally, Subsidy Theories argued that exemptions are justified because exempt entities lessen the State's burdens (and revenue needs) by providing certain services or goods that the State would have (or should have) provided otherwise—especially in cases of market or government failure. This simple, traditional formulation is quite common and can be found everywhere from textbooks on nonprofits to Supreme Court case law.[256]

More sophisticated academic Subsidy Theories have refined this traditional formulation, usually in the language of law-and-economics, and conceive of tax exemptions as subsidies given more generally to organizations engaged in specific activities—such as activities providing

[252] *See supra* note 53.

[253] *See* Bittker & Rahdert, *supra* note 30, at 305.

[254] *See* Lloyd Hitoshi Mayer & Zachary B. Pohlman, *What Is Caesar's, What Is God's: Fundamental Public Policy for Churches*, 44 HARV. J.L. & PUB. POL'Y 145 (2021) (arguing that the tax benefits to churches are based at least in part on a "soft sovereignty" theory).

[255] *See supra* notes 73–75 and accompanying text.

[256] *See, e.g.*, Alexander v. "Ams. United" Inc., 416 U.S. 752, 772 (1974) (Blackmun, J., dissenting) (stating that § 501(c)(3)'s purpose was to "assure the existence of truly philanthropic organizations and the continuation of the important public benefits they bestow").

goods usually provided by the State,[257] producing positive externalities,[258] or addressing a contracting failure.[259]

Its popularity in the literature notwithstanding, the more refined strand of Subsidy Theories faces difficult problems. The theories are, at most, incomplete, failing to account for a significant number of "subsidized" organizations that either provide a good that is not a substitute for a State-provided good (e.g., churches) or a good that the State or the market already provide (e.g., education and healthcare).[260] Moreover, the theories fail to explain why the regime does not extend to commercial enterprises that are (at least partly) focused on furthering the public good and that produce significant positive externalities—think of impact investing, Patagonia,[261] or a benevolent sandwich shop donating all of its profits to charity.[262]

Apart from providing unconvincing answers to the question of who should be subsidized, the theories also struggle to justify the subsidization method. Given the thorny administrability issues of and the equity problems arising from our charitable deduction regime, where only a select few benefit from the tax deductions, why not subsidize charities through tax credits, matching contributions, or even direct government grants?[263] Why is the opera subsidized as much as poverty relief?[264] Why is the relative efficiency

---

257 *See, e.g.*, Walz v. Tax Comm'n, 397 U.S. 664, 672–74 (1970) (considering and rejecting as necessary a justification of the charitable tax exemption based on these entities' performance of social welfare services).

258 *See generally* Kaplow, *supra* note 32 (explaining how an optimal tax system would subsidize charity by the amount of positive externalities that charities provided).

259 *See supra* notes 61–66 and accompanying text (discussing Hansmann's theory).

260 Hansmann's contracting theory does not necessarily explain the contours of the exemption. Education and healthcare are two examples where contracting problems have seemingly been resolved and for-profit provision has worked. Moreover, not all sectors in which contracting fails have resulted in the emergence of nonprofits. *See* Shaviro, *supra* note 64.

261 *See supra* note 75.

262 *See infra* notes 297–306 and accompanying text.

263 *See, e.g.*, Kaplow, *supra* note 32, at 15 (discussing from a theoretical perspective the potential distributional equivalence of credits and deductions in deciding how to subsidize charities). Some argue that this choice merely boils down to choosing the most efficient funding mechanism for charity and that this is an empirical question. However, many other reasons exist for preferring a credit over a deduction or matching grant. *See, e.g.*, Paul R. McDaniel, *Federal Matching Grants for Charitable Contributions: A Substitute for the Income Tax Deduction*, 27 TAX L. REV. 377, 397–413 (1972) (advocating for a matching grant and highlighting the pluralism benefits of the same); *see also supra* note 49 (discussing evidence showing that the formal structure of a given expenditure is an important feature and that different formal structures are not functionally equivalent); *cf.* ZELINSKY, *supra* note 48, at 135–37 (discussing how a charitable deduction to church donors lessens the perceived entanglement between church and State).

264 *See supra* note 78. *See generally* Miranda Perry Fleischer, *Theorizing the Charitable Tax Subsidies: The Role of Distributive Justice*, 87 WASH. U. L. REV. 505 (2010) (arguing for increased consideration of distributive justice, such as the purpose of the public good, in tax scholarship).

of an organization's operations not directly accounted for in the subsidization regime, especially when there are credible and significant concerns about bloated organizational costs?[265] Its failure to decisively answer such fundamental questions highlights the limits of the Subsidy Theories.

It might not be immediately evident why charities are outside the limits of tax. The family and other sovereigns are more intuitively outside of the scope of regular taxation, with the family occupying a "private" space outside of the public sphere (i.e., the organization being oriented towards the private, rather than the public, benefit and displaying a unique set of virtues and attitudes) and other sovereigns meriting exemption given their status as separate public spheres (i.e., displaying an orientation towards the benefit of *another* public). Yet the sociopolitical judgments supporting charities' exemption are fairly analogous to those underlying the exemptions for both the nuclear family and other sovereigns.[266]

We can conceive charitable organizations as meriting exemption given their unique private–public hybrid status. First, consider how charities fare under the definition of the public sphere. Charities—like other governments—are indeed oriented to the public benefit, seeking to provide benefits to a broad range of individuals outside the organization, therefore seemingly meeting the first element of the public sphere.[267] However, charities are private associations that, like families, result from private endeavors—organized and managed by individuals, not the State. In addition, their operations display worthy virtues and dispositions, some of

[265] *See supra* note 78 and accompanying text.

[266] The charitable regime provides exemptions for a wildly heterogeneous group of organizations through an extensively intricate legal framework. As such, the justification provided here is merely a prolegomenon of a more fulsome exposition of the theory of tax limits as applied to charities that I plan to undertake. Such a broader exposition also highlights exemptions' role in protecting charities from intrusion by the market and the State, as such intrusion would endanger core qualities of charity, such as its autonomous, private, and pluralistic character.

[267] *See supra* note 88 and accompanying text. The law emphasizes this public orientation, denying exemption when an organization benefits too many members or seems inappropriately inward facing. *Cf.* Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) ("An organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph unless it serves a public rather than a private interest."). *Compare, e.g.*, Rev. Rul. 70-186, 1970-1 C.B. 128 (allowing exemption for lake association that cleaned a publicly accessible lake to the whole community's benefit, not just property owners), *with* Flat Top Lake Ass'n v. United States, 868 F.2d 108, 112 (4th Cir. 1989) (rejecting the exemption of an organization that developed and maintained an artificial lake, given its inward orientation, because "[a]n organization that bases its benevolence upon some exclusive characteristic of the recipient has moved away from benefitting society"). *But see* Edward A. Zelinsky, *The Commerciality of Non-Profit Hospitals Requires Them to Be Taxed: Bringing the Debate to a Conclusion*, 42 VA. TAX REV. 401, 417–23 (2023) (criticizing the exemption of nonprofit hospitals due to their commercial nature and noting the current failure of the IRS's "community benefit standard" as applied to these entities).

which are present in the public sphere (e.g., neutrality and reasonableness) and some of which are not, but all of which are compatible with the public sphere—the second component of our definition.[268] As a result, charities can be seen as operating not as a separate public sphere or a private sphere but as an organization working somehow *in parallel* to the public and the State. (This is not to say that charities are in any way sovereign.)[269]

---

[268] These do not include, for example, operating in a manner that displays a "commercial hue." *See infra* notes 287–307 and accompanying text.

[269] Some even argue that charities are perceived to be "sovereign," a position that, while partially consistent with this Article's theory, takes too strong of a position on charities' independence and draws on the wrong concept to explain the limits of tax. *See, e.g.*, Evelyn Brody, *Of Sovereignty and Subsidy: Conceptualizing the Charitable Tax Exemption*, 23 J. CORP. L. 585 (1998) [hereinafter Brody, *Of Sovereignty and Subsidy*]. Brody sought to anchor the charitable exemption on their "sovereignty," itself finding grounding in church sovereignty. Although Brody's analysis is insightful and generative—from her comparison of charity to other exempt areas, such as other states, to her criticism of Base and Subsidy Theories—her focus on sovereignty is confusing and misguided.

It is confusing because it is unclear what kind of "sovereignty" Brody alludes to. Brody suggests that she does not mean "sovereignty" in the sense that the charitable sector has "compulsory powers that inhere in a sovereign." *See id.* at 588. Other work suggests that she might take a stronger view. *See* Evelyn Brody, *Whose Public? Parochialism and Paternalism in State Charity Law Enforcement*, 79 IND. L.J. 936, 1036 (2002) ("So, whose public does a charity serve? This Article does not reach the substance of that question, but rather focuses on the process. I argue that this decision is legitimately made by private parties . . . .").

Yet it is *precisely* those sovereign powers that give "sovereignty" its meaning—a sovereign cannot be if it must balance its powers or agree with another sovereign. As perhaps the most-quoted definition of sovereignty notes, "[s]overeign is he who decides on the exception." CARL SCHMITT, POLITICAL THEOLOGY: FOUR CHAPTERS ON THE CONCEPT OF SOVEREIGNTY 5 (George Schwab trans., Univ. of Chi. Press 2005) (1922). That ability to make exceptions and compel others to follow them is *exactly* what is at stake when we make claims about sovereignty. As a result, it is not clear what "sovereignty" Brody references nor whether her watered-down concept of sovereignty matches sovereignty's important attributes in other debates.

Brody's analysis is misleading because her theory gets a lot of descriptive and normative currency from this equivocation of the concept of "sovereignty." Brody seeks to explain the limitations on how charities operate, for example, not on efficiency grounds, but rather as manifestations of the State seeking to maintain "sovereignty" over charities and of an "unarticulated vestigial fear of a too-powerful nonprofit sector." Brody, *Of Sovereignty and Subsidy*, *supra* note 269, at 629.

As such, it is important to distinguish this Article from a view that advocates for—or describes the existence of—"charitable sovereignty." Rather, this Article makes claims about how the sovereign (in this case, I am locating it in the collective, although the theory is equally applicable if we were to locate sovereignty in the State itself) articulates claims about who and what should be exempt from the otherwise inexcusable obligation to contribute to the public. Although Brody's descriptive account of how some of these spheres outside of the public were perceived historically as separate sovereigns (e.g., other States, churches in the Middle Ages) is persuasive, such a narrative shows neither that being outside of the public sphere makes one a sovereign, nor that sovereignty is either a sufficient or necessary condition for exemption today.

In fact, the exemption of other spheres (the family most prominently, but also charities) evidences another type of concern: That of the intrusion of the State in another sphere and of taxation's ability to transform the *character* of goods and activities under its purview. In that way, it would be misguided to say that family relations are partially exempt because of a nuclear family's "sovereignty." This Article

More fully, why place charities outside of the public sphere? First, consider the general case for taxation: transforming activities that generally serve private interests into activities that partly serve or contribute to public interests.[270] To the extent that charities *already* serve those interests, charities would seem on their face to be an inappropriate subject for taxation—similar to how the "essential activities" of a government are thought to be inappropriate for taxation, thus meriting an exemption.[271] The charitable exemption embodies these public benefit requirements by, for example, limiting private benefits (e.g., through prohibitions on private inurement[272] and rules on self-dealing transactions[273]) and curtailing the benefits to other spheres—by limiting the deductibility of contributions to foreign charities and for foreign "public benefit" purposes.[274]

This argument by itself, however, proves too much: many private businesses have at least some public interests in hand (e.g., benefit corporations), but they are not exempted from ordinary taxation.[275] Perhaps most saliently, neither are "for-profit" charities—despite these organizations' explicit commitment to contribute to the public good.[276] As a result, there must be some *other* reason charities are not included in the public sphere, apart from the fact that they are directed towards public—rather than private—benefits.[277]

Second, and more critically, the charitable regime perhaps definitionally must operate privately and autonomously, separate from the State (and market). Charities' place outside the public sphere is traceable to both instrumental and intrinsic concerns about the deleterious effects that

argues instead that what is at play is a sociopolitical judgment that the State's involvement through taxation would fundamentally transform the character of some of these relationships (e.g., housework and childrearing) in a negative way and, as a result, the State should stay away.

270 This formulation is analogous to how English courts first analyzed the meaning of "charity," seeking to define whether an organization was charitable through inquiry into whether the organization's ends were directed at the "public benefit" within the Statute of Charitable Uses 1601, 43 Eliz. c. 4 (Eng.). *See* Alex Zhang, *Antidiscrimination and Tax Exemption*, 107 CORNELL L. REV. 1381, 1412 (2022). As we will see, this cannot fully justify taxation (and the charitable exemption). It takes a narrow view of taxation that has been rightly criticized as presupposing a natural entitlement to pretax income, which would logically result in the exemption of all kinds of currently taxed ventures (such as businesses that strive to do well and do good). *See* Sugin, *supra* note 111, at 114–20.

271 *See supra* note 161 and accompanying text.

272 *See, e.g.*, I.R.C. § 501(c)(3).

273 *See, e.g.*, *id.* § 4941.

274 *See* David E. Pozen, *Remapping the Charitable Deduction*, 39 CONN. L. REV. 531, 535 (2006).

275 *See* Lloyd Hitoshi Mayer & Joseph R. Ganahl, *Taxing Social Enterprise*, 66 STAN. L. REV. 387, 416 (2014).

276 *See* Malani & Posner, *supra* note 76, at 2023.

277 *See* Mayer & Ganahl, *supra* note 275, at 391–92.

significant involvement by the State (or the market) would have on charities' autonomy and their unique operations (and the virtues they foster).[278]

On the one hand, various commentators have highlighted the *instrumental* value of charities' autonomous character and their opposition to bringing them within the public sphere. By covering charities under the umbrella of the State through taxation, we risk reducing the "optimality" of a charity's operations, which are rooted in operating as autonomous private organizations. So, for example, Hansmann places charities outside of the State precisely because their autonomy and private character allows charities to provide high-quality public goods more efficiently.[279] In other cases, charities might seek to operate autonomously because they express an interest or opinion that is currently not—but could be—prevalent enough to carry support in the public sphere, as pluralists emphasize in their version of the Subsidy Theory.[280] In other words, operating at the level of the State (or the market) runs counter to being able to provide goods that are idiosyncratically desired or appreciated by a small subset of the community—e.g., small churches and community theatres—thus necessitating the autonomous and private character of charities.

On the other hand, as with the nuclear family, subjecting charities to tax might risk fundamentally altering the *intrinsically* valuable nature of their endeavors, jeopardizing charity's status as a unique autonomous and private form of organization.[281] A wide array of competing political

[278] Several scholars have emphasized autonomy's role in justifying the exemption. Professor Zelinsky, for example, has made a compelling case for the role that autonomy plays in justifying the exemption of churches. *See* ZELINSKY, *supra* note 48, xvi (rejecting the view that exemptions are just a subsidy and highlighting autonomy's role in justifying the exemption).

[279] *See* HANSMANN, *supra* note 64, at 228.

[280] *See* Atkinson, *supra* note 73; Levmore, *supra* note 73, at 404–07.

[281] Lloyd Hitoshi Mayer, *The "Independent" Sector: Fee-for-Service Charity and the Limits of Autonomy*, 65 VAND. L. REV. 51, 72–85, 114 (2012); Bishwapriya Sanyal, *NGO's Self-Defeating Quest for Autonomy*, ANNALS AM. ACAD. POL. & SOC. SCI., Nov. 1997, at 21, 22–23 (recounting conflicts between NGOs and governments, although counseling for strategic interactions between NGOs and state institutions).

theories (including Nozick's libertarianism,[282] MacIntyre's[283] or Walzer's[284] communitarianism, and Rawls's liberalism[285]) evidence sociopolitical judgments that place charitable organizations outside of the public sphere because of a concern for something akin to their autonomy—an autonomy that would be devalued by charities' inclusion in the public sphere, and an autonomy that is key to the development of unique virtues and civic behaviors. As a result, charities are best kept out of the public sphere.[286]

IV. EQUILIBRATING TAX'S LIMITS

This Article's main goal is theoretical, seeking to provide a theory that can both descriptively explain and normatively justify key parts of the exemption regime—the exemptions for nuclear families, other sovereigns, and charities. That being said, a theory lacking any practical applications risks (perhaps rightly) being characterized by those with more practical temperaments[287] as "transcendental nonsense."[288] Therefore, this Part adumbrates how the theoretical linkage between (i) abstract sociopolitical judgments about the scope of the public sphere and (ii) concrete policy decisions about the scope of certain exemption regimes promises to clarify and enlighten debates that have, until now, been analyzed in isolation.[289]

---

282 *See supra* note 108 and accompanying text.

283 MacIntyre emphasizes the role of practices in ethical development and human flourishing. His writings underscore the importance that these practices be autonomous from other practices and institutions that could alter their fundamental character and devalue the "internal goods" provided within its "practices." *See, e.g.*, MACINTYRE, *supra* note 88, xvi ("When recurrently the tradition of the virtues is regenerated, it is always in everyday life, it is always through the engagement by plain persons in a variety of practices, including those of making and sustaining families and households, schools, clinics, and local forms of political community."); *id.* at 273. That concern for autonomy is clearest vis-à-vis the market, *see* Luís C. Calderón Gómez, Robert Talisse & John A. Weymark, Bruni and Sugden on Market Virtues 7–9, 11–13 (Apr. 2024) (unpublished manuscript) (on file with author) (discussing the compatibility of MacIntyre's virtue ethics and contemporary market practice), but is also present vis-à-vis the liberal State. *See* MACINTYRE, *supra* note 88, xv.

284 *See* WALZER, *supra* note 194, at 294–95 (arguing that spheres should not interfere with other spheres, as not only does that risk the overall Walzerian project of complex equality, but it also risks tarnishing values internal to that sphere); *id.* at 92 (noting the "importan[ce] that any program of communal provision leave form for various forms of local self-help and voluntary association" given that these forms of organizations might be the only way for individuals to access certain valuable goods).

285 *See supra* note 110.

286 Legal scholars have voiced this concern as well. *See, e.g.*, Mayer, *supra* note 281, at 70–71 (arguing that absent a degree of autonomy or freedom from external interference, charities would lose their distinctive role in society, and thus be less deserving of the legal benefits afforded to them).

287 WILLIAM JAMES, PRAGMATISM: A NEW WORD FOR SOME OLD WAYS OF THINKING 7 (1907).

288 *See, e.g.*, Cohen, *supra* note 37.

289 This Article is the starting point for such analyses, which should be extended to more particular rules in different exemption regimes. *See supra* note 263.

For example, the Limits Theory makes it possible to "bring down" solid sociopolitical judgments regarding the necessary inclusion of ordinary commercial activities within the public sphere into discussions about the proper scope of exemption for activities with a commercial hue. Bringing in this context allows us to frame and rationalize live tax policy issues—for example, the exemption of sovereign wealth funds and professional sports organizations engaged in substantial commercial activity—as exemplified by the controversial PIF–PGA Tour deal. In other words, we can reframe these debates within the theory and seek to understand whether policy actions are coherent and fit with the given theoretical framework.

A key feature of the exemption regimes—across charities, other sovereigns, and the family—is the law's pervasive insistence that an activity's commercial nature vitiates exemption and justifies ordinary taxation, even when such an activity would otherwise merit placement outside the public sphere.[290] This pervasive insistence is neither arbitrary nor coincidental: Strong sociopolitical judgments support the general inclusion of all commercial activities in the scope of ordinary taxation and within the public sphere. A general requirement that the public sphere operates for the benefit of the community is common to different strands of political philosophy—from thinkers such as Rousseau, Kant, Locke, and Aquinas to more recent theorists such as Rawls, Nozick, and MacIntyre.[291]

Sociopolitical judgments situating commercial activity within the public sphere are conspicuous in our exemption regimes. Consider how the law restricts the exemption for other sovereigns. Following a legal evolution in which the notions of comity and foreign immunity were substantially narrowed across American law,[292] Congress moved to tax a state's activities of a commercial nature[293]—activities which had been previously

[290] *Cf.* Kelman, *supra* note 128, at 838 (arguing that one's voluntary entrance into the market is dispositive in turning labor taxable).

[291] *See supra* note 88 and accompanying text.

[292] The Foreign Sovereign Immunities Act of 1976 (FSIA) embodied that evolution, in which the United States adopted a more restrictive theory of sovereign immunity. 28 U.S.C §§ 1330, 1332(a), 1391(f), 1602–1611; *see also* STAFF OF JOINT COMM. ON TAX'N, *supra* note 1, at 42. In 1986, changes to the Code and regulations would "parallel" the FSIA and exclude from the exemption income earned from commercial activities. *See id.* at 44 n.107 ("By excluding income earned from commercial activities from the exemption, the regulations paralleled the limitations on sovereign immunity statutorily adopted in the FSIA.").

[293] *See* I.R.C. § 892(a)(2) (enacted in 1986); *see also* T.D. 7707, 1980-2 C.B. 213 (promulgating final regulations under a pre-1986 version of § 892 and aiming to exclude from the exemption commercial entities, despite textual support in the prior version of § 892 and practice for the exemption of commercial activities).

exempted.[294] In doing so, Congress decided to include these activities within the ordinary scope of taxation, even though the normative underpinnings of comity would suggest that they should not have been included. After all, such commercial activities would still be run by another equal state, and such a state could use those funds to further its "essential activities," which, in turn, would remain exempt.[295] Thus, a purposive analysis suggests that these activities should have remained exempt. Yet legislative and regulatory reforms excluded all commercial activities from the exemption, regardless of their noncommercial purposes or of normative justifications that would have otherwise supported their exemption.[296] Similarly, an extensive area of the law delimits the kinds of municipal bonds that pay tax-exempt interest,

[294] *See* David R. Tillinghast, *Sovereign Immunity from the Tax Collector: United States Income Taxation of Foreign Governments and International Organizations*, 10 LAW & POL'Y INT'L BUS. 495, 507 (1978) (discussing how the IRS had ruled that certain commercial activities by foreign governments were exempt under § 892). However, the IRS enacted regulations to clarify that the broad language of § 892 did not extend to commercial activities. T.D. 7707, 1980-2 C.B. 213. Despite the 1980 regulations, the Code language before the 1986 Tax Reform was broad enough that it was unclear whether the regulation's limitation was consistent with the statute. *See* STAFF OF JOINT COMM. ON TAX'N, 100TH CONG., JCS-10-87, GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1986, at 1058–59 (Comm. Print 1987) [hereinafter JCT GENERAL EXPLANATION] ("Third, under a literal reading of prior statutory language, not only was income of foreign governments from stocks, bonds, etc., exempt from U.S. tax, income 'from any other source within the United States' was exempt, too. While Regulations properly limited this exemption to other investment income, Congress intended to make it clear that the exemption applies only to specified income items.").

[295] The Senate Report enacting the exclusion for commercial activities noted Congress's concern with the commercial nature of the activities. *See* JCT GENERAL EXPLANATION, *supra* note 294, at 1058–59. It rejected the rationale that they should remain exempt because these commercial activities yielded profits to foreign governments, even when these commercial activities were cultural or sports-related. *Id.*; *see also* Khushmatova, *supra* note 168 (surveying the commercial exclusion in an international context).

[296] Fleischer, *supra* note 79, at 458 ("Eventually this test was replaced with a more specific inquiry into the commercial or non-commercial nature of the activity conducted by the foreign sovereign rather than the organization conducting the activity.").

The law has retained a limited exemption for states' direct commercial activities, but the exemption is unavailable for commercial activities operated by a separate legal entity (that is, a "non-integral part") of the state. *Compare* Rev. Rul. 71-131, 1971-1 C.B. 29 (1971) (exempting the income derived from the operation of liquor stores by the State of Montana from federal income tax), *with* I.R.S. Field Serv. Mem. 199942008 (Oct. 22, 1999) (advising that a fund claiming an exemption because it performed an essential governmental function did not qualify for the exemption due to its commercial nature). This line is clearer in the context of the exemption for Indian Tribal Governments, whose exemption is limited statutorily to essential governmental activities. *See, e.g.*, I.R.C. § 7871(c)(1) (limiting the deductibility of Indian Tribal Government's bond interest to bonds whose proceeds are substantially "to be used in the exercise of any essential governmental function"); *id.* § 7871(e) ("For purposes of this section, the term 'essential governmental function' shall not include any function which is not customarily performed by State and local governments with general taxing powers.").

separating the exempt ones from those that are too intertwined with private parties and interests and thus are taxed.[297]

But the charitable regime is perhaps the clearest example of how the law seeks to restrict commercial activities from accessing the exemption. Imagine a church has set up a chicken sandwich shop; the church operates the business for profit, but the shop uses all profits to further charitable purposes consistent with the church's own—for example, the alleviation of poverty. Should the sandwich shop be liable for federal income taxes? Prior to 1950, the sandwich shop would have benefitted from exemption; however, that is no longer the case.[298] We currently have a robust system, the Unrelated Business Income Tax (UBIT), expressly directed at taxing these activities and ensuring that they remain inside the scope of regular taxation and, thus, the public sphere.[299] The law's insistence on taxing these activities is

[297] *See* I.R.C. §§ 103(b)(1), 141 (generally excluding "private activity bonds" from the § 103 interest exemption); *id.* § 141(c)(6)(A) (defining "private business use" as "use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit"); Treas. Reg. § 1.141-3 (further defining the "private business use" test); I.R.C. §§ 141(e), 142–145 (providing for the exemption of certain private activity bonds that are "qualified bonds").

[298] Prior to 1950, "feeder" commercial organizations, which remitted all of their income to charitable activities, were tax exempt. *See* Roche's Beach, Inc. v. Comm'r, 92 F.2d 776, 779 (2d Cir. 1938); Trinidad v. Sagrada Orden de Predicadores, 263 U.S. 578, 581 (1924) (finding that a tax-exempt organization did not lose its exemption because it engaged in limited commercial activities, as long as the income from those activities was destined to fund its mission). *But see* Better Bus. Bureau of Wash., D.C. v. United States, 326 U.S. 279, 283 (1945) ("[T]he presence of a single [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly [exempt] purposes."); C.F. Mueller Co. v. Comm'r, 14 T.C. 922, 927 (1950) (declining to apply *Roche's Beach*'s destination-of-income test and sounding the death knell for the test), *rev'd*, 190 F.2d 120 (3d Cir. 1951).

[299] *See* I.R.C. §§ 511–515. The legislative history of the UBIT evidences a disapproval of for-profit activities by charities. *See* H.R. REP. NO. 81-2319, 81st Cong., 2d. Sess., 36 (1950); Berrien C. Eaton Jr., *Charitable Foundations and Related Matters Under the 1950 Revenue Act: Part I*, 37 VA. L. REV. 1, 2 (1951) (recounting the events prior to the 1950 tax reform and noting that "tax-exempts—including the foundations—were responsible for their own limelight" and that "[t]he information that New York University was, albeit indirectly, engaged in manufacturing spaghetti just naturally produced a few raised eyebrows").

incompatible with both traditional[300] and law-and-economics[301] Subsidy Theories of the charitable regime. Moreover, that insistence highlights the strong sociopolitical judgment seeking to safeguard charities' character and prevent them from turning into another commercial enterprise.[302]

[300] Different theories of the exemption will provide different answers on whether we should tax the church's chicken shop. A Subsidy Theory focused on the "worth" of the church's mission, such as Colombo and Hall's, will struggle to explain why the exemption should not be extended to the chicken sandwich shop. *See* COLOMBO & HALL, *supra* note 41. After all, if the rationale for the exemption is that the exemption results in the provision of valuable services—the alleviation of poverty—why would it matter whether the church receives funds to provide those services through donations or the operation of its sandwich shop, especially if customers are motivated by the church's charitable mission? An appeal to competition is inapposite, as these theories are concerned with increasing the provision of favored goods (i.e., alleviation of poverty)—a goal incommensurable with "ensuring fair competition" (i.e., reduced profits for Chick-fil-A, a competitor of our sandwich shop).

[301] A law-and-economics subsidy account is probably better suited to justify our UBIT regime by pointing out the hypothetical competitive effects that its absence could bring. Several questions remain, however.

First, theories like Hansmann's justify the potential distortionary effects of the exemption and the deductibility of contributions as a way to provide more capital to nonprofits; as a result, it is unclear why these theories would reject such additional distortions (in this case, to competition), especially absent a finding that nonprofits are sufficiently capitalized as a result of the exemption and charitable contribution deduction.

Second, it is unclear what harms law-and-economics accounts could cognize from a tax-exempt business underpricing a nonexempt business. After all, these accounts are usually married to the still-hegemonic view that consumer welfare—in the form of reduced consumer prices—is the goal of competition policy. *See* ROBERT H. BORK, THE ANTITRUST PARADOX 7 (1978). *But cf.* Lina M. Khan, *Amazon's Antitrust Paradox*, 126 YALE L.J. 710, 737–46 (2017) (arguing for a wider conception of antitrust policy goals where the consumer welfare approach is too narrow and inconsistent with congressional intent). Moreover, the UBIT regime does not ban all commercial activities—just commercial activities "unrelated" to the organization's purpose. So, while the sandwich shop's income will be taxed to the church, a bookstore's income would not be taxed to a museum. I.R.S. Priv. Ltr. Rul. 201429029 (Apr. 24, 2014) (finding that art museum's shop that exclusively sold items related to art was not subject to the UBIT).

[302] A theory about tax limits is better suited to explain our regime. The underlying problem with a tax-exempt business is not that other businesses will be at a disadvantage. Again, that is an empirical claim for which there is not much support. *See, e.g.*, Michael S. Knoll, *The UBIT: Leveling an Uneven Playing Field or Tilting a Level One?*, 76 FORDHAM L. REV. 857, 866–71, 890–91 (2007) (arguing that from a theoretical perspective, tax exemption does not provide nonprofits a competitive advantage over for-profits, as nonprofits face a higher discount rate in evaluating investments, and that the UBIT actually disadvantages nonprofits relative to for-profit enterprises); SUSAN ROSE-ACKERMAN, *Unfair Competition and Corporate Income Taxation*, *in* THE ECONOMICS OF NONPROFIT INSTITUTIONS 395, 405 (1986). Moreover, the UBIT regime is a crude tool to stop "unfair" competition, being both under- and over-inclusive for that goal.

The regime is underinclusive in its aim to stop unfair competition because it does not apply to either a trade or businesses "related" to a tax-exempt organization's mission or to a commercial undertaking that does not rise to the level of a trade or business—for example, because the activities are not considerable, regular, or continuous enough. *See* Comm'r v. Groetzinger, 480 U.S. 23, 35 (1987). Consequently, as Rose-Ackerman noted, the UBIT at most shifts—rather than eliminates—"unfair"

Running a tax-exempt organization like a business contradicts a charity's operation as parallel to the public sphere and is therefore in tension with the exemption's justification—regardless of the business's corporate mission, the CEO's moral compass, the worthiness of the company's products, or the second-order externalities that the enterprise might generate.[303] The law can thus be best explained as using the commerciality regime to include within tax's limits regular commercial activities that should *otherwise* contribute to the benefit of the public.

But why do so if those commercial activities yield profits that will eventually be destined for charitable purposes? In a similar vein, why would we revoke the church's exemption if the chicken sandwich shop became a significant operation? Because even if the *consequences* of the sandwich shop's activities eventually yield benefits to the public, the law is also concerned with how those benefits are attained: with their "commercial hue."[304] At a deeper level, the law seems to reflect a judgment that the tax-exempt organization's charitable dispositions are "crowded out" by the commercial business's operations.[305] In this way, we might say that the

competition to certain industries where tax exempts could more easily argue that the businesses align with their mission (think publishing, housing, or healthcare). *See* ROSE-ACKERMAN, *supra*, at 405.

Furthermore, the overall commerciality and UBIT regimes are overinclusive. First, if a tax-exempt entity's unrelated business activities are "too significant," judicial doctrines operate to revoke an entity's tax exemption—even when its business's competitive harms have been addressed through the levy of the UBIT—placing such exempt entity and its nonexempt competitors on the same tax footing. *See* Rev. Rul. 64-182, 1984-1 C.B. 186. The denial of the exemption, therefore, operates as an excessive punishment unrelated to any competitive harm that might result from the operation of a for-profit business. Second, the regime all but forbids tax exempts from engaging in corporate transactions or joint ventures with for-profit entities. For example, strict rules apply to joint ventures, requiring that in any joint venture with a for-profit entity, the tax-exempt must control the joint venture to retain its exemption—as a matter of fact and as a matter of law. *See* Rev. Rul. 98-15, 1998-12 I.R.B. 6 ("[I]f a private party is allowed to control or use the non-profit organization's activities or assets for the benefit of the private party, and the benefit is not incidental to the accomplishment of exempt purposes, the organization will fail to be organized and operated exclusively for exempt purposes."); Estate of Hawaii v. Comm'r, 71 T.C. 1067, 1082 (1979), *aff'd*, 647 F.2d 170 (9th Cir. 1981); I.R.S. Priv. Ltr. Rul. 9616005 (noting that the venture's documentation must assure that the joint venture is at all times controlled by the tax-exempt entity and that the tax-exempt entity must control the joint venture for its charitable purpose). *But see also infra* note 310 (discussing how structuring considerations might affect the application of these doctrines).

303 The regime does not even make a distinction for certified "good" corporations, such as B-Corps. *See* Mayer & Ganahl, *supra* note 275, at 416–18 (2014).

304 Airlie Found. v. I.R.S., 283 F. Supp. 2d 58, 63–64 (D.D.C. 2003); Easter House v. United States, 12 Cl. Ct. 476, 486 (1987); Am. Inst. for Econ. Rsch. v. United States, 302 F.2d 934, 938 (Ct. Cl. 1962).

305 There is extensive literature in philosophy and psychology on incentives and market logic's "crowding out" effects. *See, e.g.*, Uri Gneezy & Aldo Rustichini, *A Fine Is a Price*, 29 J. LEGAL STUD. 1 (2000) (analyzing behavioral effects of penalties); MICHAEL SANDEL, WHAT MONEY CAN'T BUY: THE MORAL LIMITS OF MARKETS (2012) (asking and answering the question of markets' proper role and their moral limitations in a democratic society). Furthermore, there is some evidence that direct government

overall organization has transformed from a church into a chicken sandwich shop—albeit one with unimpeachable aims.[306] By doing so, however, the organization has stopped operating as if it were *outside* of the public sphere; it operates now like any regular business and should be taxed accordingly.

Although this commerciality principle, present across exemptions, is seemingly trivial without factual context, it helps provide a framework which renders policymakers' criticisms of the PIF–PGA Tour transaction both legally intelligible and salient. Recall that public concern over the PIF–PGA Tour transaction has highlighted how the transaction's design seems not to further a public purpose, but rather to assist the parties in scaling and operating a more profitable enterprise. The PGA Tour has responded to those concerns partly by insisting that increased scale would empower it to further advance professional golf.[307]

The Limits Theory—and an understanding of the principle of commerciality—clarify the relevance of Senator Wyden's concerns about the commercial nature and size[308] of the combined enterprise and the irrelevance of the PGA Tour's stated goal. As we have seen, the law does not excuse commercial behavior by a tax-exempt entity, even if the proceeds of the commercial enterprise are later used to further a charitable cause. "Making more money to put on more golf tournaments and advance golf" is simply not a legally relevant response to Wyden's criticism. Activities run in a commercial manner should not be exempt, *even if they in some way*

---

support, for example, can crowd out fundraising by charities, critically severing a link between a charity and its donors. *See* James Andreoni & A. Abigail Payne, *Is Crowding Out Due Entirely to Fundraising? Evidence from a Panel of Charities* (Nat'l Bureau of Econ. Rsch., Working Paper No. 16372, 2011), https://www.nber.org/papers/w16372 [https://perma.cc/HM65-PU2C].

306 In applying § 501(c)(3)'s operational test, a court recounted

> [C]ourts have relied on what has come to be termed the "commerciality" doctrine. In many instances, courts have found that, due to the "commercial" manner in which an organization conducts its activities, that organization is operated for nonexempt commercial purposes rather than for exempt purposes. Among the major factors courts have considered in assessing commerciality are competition with for profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves.

Airlie, 283 F. Supp. at 63 (citations and footnotes omitted). Other factors include, for example, "whether the organization uses commercial promotional methods (e.g., advertising) and the extent to which the organization receives charitable donations." *Id.* More succinctly, it is insufficient for an organization not to operate for commercial ends; it must also refrain from overly engaging in commercial means.

307 *Agreement Establishes Common Goal to Promote and Grow the Game Globally for the Benefit of All Stakeholders, Ends Litigation*, PGA TOUR (June 6, 2023), https://www.pgatour.com/article/news/latest/2023/06/06/pga-tour-dp-world-tour-and-pif-announce-newly-formed--commercial-entity-to-unify-golf [https://perma.cc/X9FA-6DSN].

308 The size of the combined enterprise here is seen as evidence of its commercial nature.

further a public purpose. The problem is the means taken towards that end: commercial means that vitiate the exemption.[309]

Furthermore, the PIF–PGA Tour case presents more pressing commerciality concerns than the example of the church and the sandwich shop. Unlike in the church example, the PGA Tour would devote most of its assets and operations to the joint *commercial* enterprise. As such, the Limits Theory renders Senator Wyden's intuitive criticisms intelligible and justifies the revocation of the PGA Tour exemption—either by clarifying the existing law or by changing the law so that it better coheres with the underlying intuition that such a commercial enterprise should not be awarded an exemption, even if it furthers some arguably worthy purposes.[310]

---

[309] Although the PGA Tour qualifies as tax-exempt under § 501(c)(6) rather than § 501(c)(3), which covers most nonprofit exempt entities, the legal principles and restrictions that apply to § 501(c)(3) also underlie § 501(c)(6)—albeit with a more limited concern about commerciality. *See* Treas. Reg. § 1.501(c)(6)-1 ("An organization whose purpose is to engage in a regular business of a kind ordinarily carried on for profit, even though the business is conducted on a cooperative basis or produces only sufficient income to be self-sustaining, is not a business league."); *see also* Rev. Rul. 58-294, 1958-1 C.B. 244. As such, this Article's analysis of charities is generally applicable to the PGA Tour.

[310] The blackletter law on this issue can be a little trickier than it would seem. In seeking to defend its exemption, the PGA Tour will likely argue that its combination is less like the church's chicken shop (which is taxed under the UBIT and would endanger an organization's exemption if its UBIT activities became too substantial) and more like a museum's gift shop (which is not taxed under the UBIT and is allowed an exemption). *See* I.R.S. Priv. Ltr. Rul. 201429029. However, the extent of the PGA Tour's commercial activities and its pursuit of profit seriously raise the question of whether the organization can meaningfully maintain that it is not being operated like a regular business. *Cf.* Rev. Rul. 78-51, 1978-1 C.B. 165; Eng'rs Club of S.F. v. United States, 791 F.2d 686, 689 (9th Cir. 1986) (noting that a § 501(c)(6) organization "should not be engaged in a regular business of a kind ordinarily conducted for a profit").

However, the previous analysis could be further complicated by the corporate form of the combination. If the combination takes the form of a joint venture or a partnership, it will have to follow IRS guidelines. *See, e.g.*, Rev. Rul. 2004-51, 2004-1 C.B. 975; Rev. Rul. 98-15, 1998-12 I.R.B. 6; *see also* St. David's Health Care Sys. v. United States, 349 F.3d 232 (5th Cir. 2003). These generally require (i) that the charitable entity controls the activities of the venture, and (ii) that the venture's organizational documents expressly prioritize the exempt partner's charitable mission of the charitable entity over the for-profit partner's quest for profit. Moreover, the venture's activities will be attributed to the controlling charitable partner for purposes of the organizational test it will have to pass to retain its exemption. That being said, the law gets murkier if the parties decide to effect their combined venture through a separate taxed corporate subsidiary (or through the use of a blocker), as the activities of which would not normally be attributed to the charitable shareholder. *See* Ron G. Nardini, Menachem Danishefsky & Ekaterina V. Lyashenko, *To Partner or Not to Partner—It's an Exemption Question*, TAX'N EXEMPTS (Thomas Reuters, Boston, MA), Mar.–Apr. 2018 (discussing several structuring advantages of a taxed corporate subsidiary, such as avoiding the attribution of the subsidiary to the charitable entity for operational test and UBIT purposes); I.R.S. Priv. Ltr. Rul. 199938041 (ruling that the activities of a taxed corporate subsidiary will not be attributed to its charitable owner if the subsidiary has a bona fide business and it is not an instrumentality of the charitable entity); I.R.C. § 512(b)(13) (providing that otherwise UBIT-excluded payments such as dividends would be taxed under the UBIT if an entity is a "controlled entity," with a 50%-vote- or value-test for "control"). *But see* I.R.S. Tech. Adv. Mem. 200437040 (June 7, 2004)

In addition, insofar as the PIF is engaged in running an ordinary business in the United States—as suggested by the descriptions of the deal—then any income it receives should not be exempt.[311] Again, that result seems compelled by the law, yet legal ambiguities might permit the PIF to be exempt for certain income from these joint operations. This Article provides a theoretical background that rationalizes, justifies, and contextualizes these legislative moves to deny the PIF its tax exemption. Although some of these proposals have tied the exemption not to commerciality but to foreign relations-type considerations,[312] the foregoing analysis is still illustrative: To the extent these organizations are operating in the United States in contravention of significant interests of the public sphere—rather than parallel to the U.S. public sphere—such activities might not warrant the "degree of comity" that the exemption is granting.

In this way, a theory of tax's limits allows us to "bring down" these high-level sociopolitical judgments about the place of commercial activities within the public sphere to tax policy discussions. As the PIF–PGA Tour controversy shows, doing so is generative. The Limits Theory provides both a context and a framing for (until now) viscerally persuasive but legally incognizable criticisms regarding (i) the combined entity's size and commerciality and (ii) the PIF's opposition to U.S. public policy. In addition, the theory sketches a path forward, setting the agenda for both potential litigation that would clarify existing law so as to make it more coherent and for legal reforms that would better align specific legal rules and doctrines with the sociopolitical judgments that justify them.

(noting that a taxable for-profit subsidiary's operation of substantial economic activities retention of earnings therefrom, without distributions to a charitable parent for expenditures on charitable activities, could result in revocation of the group's tax exemption). Senator Wyden has introduced bills to arrive at a result that revokes the exemption more clearly. *See supra* note 16.

311 *Cf. supra* note 291 and accompanying text. That is not to say that the Limits Theory ought to result in the taxation of all investment activities by other sovereigns or SWFs. A possible approach would distinguish between the PIF's active investment in the PGA Tour and other sovereign investors' limited passive investments in the U.S. capital markets, drawing on the law's current distinctions between (i) "investment" and (ii) "commercial" or "business" activities. *C.f.*, *e.g.*, Leandra Lederman, *The Entrepreneurship Effect: An Accidental Externality in the Federal Income Tax*, 65 OHIO ST. L.J. 1401 (2004) (exploring this distinction in another context). Such a distinction could justify the exemption of investment activities, but not of business or commercial activities, because investment activities *are* usually conducted by sovereigns (therefore being akin to an "essential governmental function"). *Cf. supra* note 293. Drawing the limit at investment activity and tying that limitation to the understanding that more active business or commercial endeavors are not "essential governmental functions" both (i) aligns this area of the law with contiguous areas where that distinction is present and (ii) connects the limitation to the comity and federalism justifications underlying the exemption.

312 *See* The Ending Tax Breaks for Massive Sovereign Wealth Funds Act, S. 2518, 118th Cong. § 2 (2023) (defining "Non-Exempt Foreign Government" as a foreign government that either (i) does not have a free trade or income tax treaty with the United States or (ii) is a "covered nation" under laws preventing the acquisition of sensitive materials, such as China, Iran, Russia, and North Korea).

CONCLUSION

An exploration of the law of tax exemptions reveals that exemptions are neither arbitrary nor mere subsidies. Rather, the exemptions of the nuclear family, other sovereigns, and charitable organizations elucidate that tax exemptions are best understood as reflecting widespread sociopolitical judgments about the limits of the public sphere regarding taxation. In doing so, the Limits Theory better explains and justifies the law of tax exemptions, clarifying doctrinal developments—such as the exemption of imputed income from household labor, the nonreciprocal exemption of foreign governments' income, and the UBIT—that were unexplainable under prevailing theories.

Perhaps more importantly, a normative theory framing the law of tax exemptions allows us to "bring down" sociopolitical judgments to resolve convoluted and confused tax-policy discussions. For example, unearthing and justifying the pervasive rules against commerciality running through the law of tax exemptions enables us to better frame the criticisms against the PIF–PGA Tour deal—emphasizing how the combined entity's size, purpose, and mode of operation are relevant to a legal determination of whether they should retain their exemptions. Moreover, the Limits Theory delivers a concrete agenda for litigation and legal reform, aiming to clarify or reform certain rules to better cohere with the overall legal regime and its justification. In this way, the Limits Theory enables us to go from law to theory and back to law: The theory rationalizes the main features of the law, it uses the law's existing normative underpinnings to resolve particular legal conflicts, and it allows us to propose reforms that make the law more coherent with those normative underpinnings.

But there is another way in which the theory is generative in the policy arena. Clarifying the linkage between tax exemptions and sociopolitical judgments regarding the scope of the State and the public sphere should also allow us to "bring up" policy debates about tax exemption. That is, the Limits Theory can, for example, enrich policy debates by allowing proponents of particular reforms to an exemption regime to better present their proposals, framing them as policy changes meant to more accurately reflect existing (or evolving) sociopolitical judgments about the scope of the public sphere. Take, for example, proposals to end the exemption for income from housework. Although these proposals are usually framed in traditional tax-policy language—the language of efficiency, equity, and administrability—the Limits Theory opens additional avenues for debate. Feminists could, for example, frame this reform as flowing from the *public* nature of housework. They could then debate the importance—particularly in terms of gender equity and the inclusion of women and caregivers as full members of the public—of fully including this work in the public sphere.[313] Addressing the sociopolitical judgments that underlie the current legal rules portends to be an opportune avenue for reform, especially in light of changing attitudes towards traditional gender roles and family composition. The Limits Theory thereby unlocks opportunities for a broader (and promising) evolution of the tax-exempt arena.

313 Feminist scholars in other fields have suggested such a move, but it has yet to gain traction in tax. *See* Silbaugh, *supra* note 80.