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CHASING PROFITS — DISREGARDING VALUES: LEGAL PERSONA OF ELITE SCHOOLS AND THEIR DESTRUCTIVE TAX-EXEMPT STATUS

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"[Money] changes my wishes from being imaginary, and translates them from their being in thought, imagination, and will into a sensuous, real being, from imagination to life, from imaginary being to real being. The truly creative force in this mediation is money."[1]

I. INTRODUCTION

Money in the Modern World: The Ultimate Desire

"It is pretty to see what money will do."[2]

Throughout millennia, people of all generations have been chasing money:[3] eager to accumulate as much money as possible, in the shortest period possible, paying the lowest tax possible. Thus, money—often condemned as "yellow slave" that "knit[s] and break[s] religions"[4]—has been a primary stimulator for the

* The John Marshall Law School, 2010. I want to express my boundless gratitude to my mother Lusia Koltko for all the love, encouragement, and support she has given me, as well as the sacrifices she has made so her children could "live the American dream." Thank you, mom, for teaching me from my early childhood the importance of education.

1. KARL MARX, *Economic and Philosophical Manuscripts of 1844, in* KARL MARX: SELECTED WRITINGS 110 (David McLellan ed. & trans. (in part), Oxford Univ. Press 1977).

2. Samuel Pepys, English Diarist, Diary, Mar. 21, 1667, *available at* http://www.pepys.info/1667/1667mar.html.

3. *See generally* JAMES BUCHAN, FROZEN DESIRE: THE MEANING OF MONEY (1997) (analyzing the roots and nature of money, its potency in being desirable, and different perceptions of money by gender through centuries).

4. *Id.* at 94. In his book, Buchan vividly expresses his feelings about the devastating ability of money to devalue societies. *See generally id.* Throughout history, others as well have lamented that "the money is promiscuous . . . immoral," "depreciated paper which is stamped with the indelible mark of sacrilege." *See, e.g.*, John Laughland, *Frozen Desire: The Meaning of Money*, NAT'L. REV., Nov. 10, 1997 (reviewing JAMES BUCHAN, FROZEN DESIRE: THE MEANING OF MONEY (1997)) (comparing attitudes of Edmund Burk and James Buchan toward money). In his book review, Laughland develops arguments to counter Burke's and Buchan's almost

continuous evolution of individuals, corporations, and the world in general. This type of evolution is called commercialization.[5]

In their turn, for centuries, universities have been devoted to chasing ethereal excellence, wisdom, and morality. Because of this righteous behavior, the government has rewarded universities by permitting such entities to pay the lowest tax possible—no tax. Namely, the government exempted schools from taxation. But wait! The Earth is flat again: schools stopped chasing enlightenment and are in pursuit of a not so ethereal, pecuniary wealth. Indeed, elite schools are being assimilated into money-spinning machines, steadily metamorphosing into lucrative enterprises.[6] Undeniably, commercialization of the noncommercial sphere—education—is an all-around consuming occurrence. This dramatic shift in the behavior of educational institutions is a cause for questions as to the nature and degree of the change as well as to the possible implications on the legal status of these institutions. Precisely such great questions are facing, or should face, Congress in the province of taxation of higher education's enormous endowments. Congress must revisit the purpose of tax exemptions and re-examine the new identities of old players on the tax field.

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diabolic vision of money. *See id.*

5. *See* DEREK CURTIS BOK, UNIVERSITIES IN THE MARKETPLACE: THE COMMERCIALIZATION OF HIGHER EDUCATION 3 (2003) (specifying that commercialization, corporatization, and commodification are often used interchangeably). In his book, "commercialization is used to refer to efforts within the university to make a profit from teaching, research, and campus activities." *Id.* at 3. By definition, although not clear, the changes in the institutions of higher learning under the impact of the market economy are called corporatization. William Scheuerman & Thomas Kriger, *Introduction —The Concept of Corporatization: A Useful Tool or Feel-Good Slogan?*, AM. ACAD., June 7, 2004, at 8, *available at* http://www.aft.org/pubsreports/American_academic/issues/june04/Scheuerman.qxp.pdf.

Some authors refer to corporatization as "market encroachments on institutions of higher learning." *Id.* at 11. Others articulate that corporatization, ideological in its nature, represents "the universities' choice to respond to financial pressures by embracing private market ideology." Risa L. Lieberwitz, *The Corporatization of the University: Distance Learning at the Cost of Academic Freedom?*, 12 B.U. PUB. INT. L.J. 73, 129 (2002) [hereinafter Lieberwitz, *Distance Learning*].

6. To corroborate the process of said metamorphosis, it is imperative to compare the traits of the corporations with the traits of the mutated higher education. Unequivocally, they share common features such as eagerness and dedication to the race to the top for profits that is accompanied, as a trade-off, by the pressure to abandon their core values. *See, e.g.*, Scheuerman & Kriger, *supra* note 5, at 12 (comparing and contrasting the goals of the business sector with those of higher education). In the ideal world, the true objectives of schools—greatly distinct from those of the corporate field—have been to educate students to pursue the truth, to encourage dissent, and to build tolerance to the differing opinions. *Id.* at 12.

While delving into the phenomenon of commercialization of private and public schools, Part II of this Comment explores the transformation of tax-exempt schools into powerful enterprises by focusing on their endowments, techniques utilized to multiply these endowments, and the consequences of maintaining tax-exempt status. Part III examines the origin, history, and purpose of schools' tax-exempt status. Further, it reveals the legislative failure to account for the drastic evolution of schools and their new legal persona. Part IV discusses the current proposals and their inadequacies. The Comment concludes with a proposal to partially change the legal status of schools and to adjust adequately the tax treatment of schools by imposing a unified tax.

II. BACKGROUND

The phenomenon of commercialization in higher education is not new.[7] But the size of the accumulated funds, as a result of commercialization,[8] the techniques employed to attract and multiply these funds, the types of the institutions engrossed in the corporatization processes,[9] and the level of concentration on the profit-generation are new.[10]

A. Commercialization of Schools: Monetary Epidemic

> "Universities share one characteristic with compulsive gamblers and exiled royalty: there is never enough money to satisfy their desires."[11]

The universities' commercialization process is deemed to have originated immediately after the Civil War with interschool

7. BOK, *supra* note 5, at 2. For example, by the early 1900s, the University of Chicago was already advertising regularly to attract students. *Id.* at 2; *see also* Scheuerman & Kriger, *supra* note 5, at 17 (asserting that marketplace encroachments on academia have been obvious for over one hundred years).

8. BOK, *supra* note 5, at 2-3.

9. It is important to note that the primary focus of this Comment is the behavioral patterns of private schools in the market economy; nevertheless, public schools are also illustrative of the commercialization processes as both sectors engage in quite analogous revenue-generating activities. *See generally* Gary Rhoades & Sheila Slaughter, *Academic Capitalism in the New Economy: Challenges and Choices*, AM. ACAD., June 7, 2004, *available at* http://www.aft.org/pubs-reports/american_academic/issues/june04/Rhoades.qxp.pdf (focusing their research on the behavior of public schools in the age of the academic capitalist regime). Public colleges and universities have become particularly aggressive commercially after they faced major cuts in state financial support. *Id.* at 37.

10. *Id.* The difference between the past and present academic commercialization is in its "breadth and depth." *Id.*

11. BOK, *supra* note 5, at 9 (questioning the effects of only "excessive commercialization").

athletic competitions.[12] Later, in 1905, high participation of athletes, media, and observers in the collegiate competitions led Harvard to hire a football coach whose salary was equal to the salary of its president.[13] In 2007, for the first time, the average salary of 120 college football coaches reached one million dollars per year.[14] Even now, in the depressed 2009 economic climate, the college sports industry is a lucrative enterprise despite the deteriorating economic conditions around it.[15] For instance, after receiving billions of dollars in federal stimulus cash, Kentucky invested millions of it "in a well-traveled but highly successful . . . [college] basketball coach."[16] Other college coaches continue receiving millions under their contracts while universities' administrations cut budgets in other academic areas.[17]

Further, limitless opportunities for earning money emerged after World War II and created an incredibly demanding and rapidly growing society.[18] At that time, professionals felt the need to perfect their skills and acquire new expertise to adapt to the competitive and complex market.[19] Thus, schools attracted more students.[20] Subsequently, developments in biotechnology and

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12. RONALD A. SMITH, SPORTS AND FREEDOM: THE RISE OF BIG-TIME COLLEGE ATHLETICS 10 (1988) (describing that in the post-Civil War period, schools became more receptive to and even began to support competitive sports at an institutional level); BOK, *supra* note 5, at 35-36 (claiming that the first truly intercollegiate sports contest in the United States with commercial tones took place between a Yale student and a Harvard student as a result of the "brainchild" of a railroad owner and a real estate developer, organized to attract public attention to Southern New Hampshire).

13. BOK, *supra* note 5, at 2.

14. Steve Wieberg & Jodi Upton, *The Money Game: College Football Coaches Calling Lucrative Plays*, USA TODAY, May 12, 2007, at A1, *available at* http://www.usatoday.com/sports/college/football/2007-12-04-coaches-pay_N.htm. In contrast, in 2001, only thirty university coaches were earning over one million per year. BOK, *supra* note 5, at 38.

15. *See generally* Joshua Rhett Miller, *Cash Strapped States Pay Millions for Basketball Coaches*, FOXNEWS.COM, Apr. 2, 2009, http://www.foxnews.com/story/0,2933,512227,00.html.

16. *Id.* In February 2009, the State of Kentucky received almost $3 billion in federal stimulus cash to "preserve 'quality of life.'" *Id.* Shortly thereafter, the State invested $32 million in order to pay John Calipri, a basketball coach at the University of Kentucky, $4 million a year for 8 years in accordance with his employment contract. *Id.* In fact, Mr. Calipri is making thirty-five times more than the governor of the State. *Id.*

17. *Id.*

18. BOK, *supra* note 5, at 12.

19. *Id.* at 11-15.

20. From 1945 to 1965, the postsecondary school enrollment grew by 300%. STANLEY ARONOWITZ, THE KNOWLEDGE FACTORY: DISMANTLING THE CORPORATE UNIVERSITY AND CREATING TRUE HIGHER LEARNING 2 (2001). Within thirty years after World War II, college and university enrollment grew by two and a half times, and it continues to grow now. *Id.*

genetics overwhelmed the science field; as a result, in addition to seeking countless patents, schools were accepting large sums from the firms that were interested in receiving scientific help in their own research projects.[21] Those developments also enabled science professors to find ways to supplement their professorial income with lucrative activities on the side.[22]

In response to these developments in science, Congress enacted The Bayh-Dole Act (the "Act") in 1980 that simplified the process of obtaining a patent or a license for an invention.[23] The Act also allowed for a possible retention of a title to an invention by a nonprofit organization or business firm even if the invention was a final product of a federally funded research.[24] Under the Act, schools could collect royalties and licensing fees from the patents on academic inventions.[25] Overall, the purpose of the Act

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Simultaneously, to meet demand for knowledge, the schools' primary responsibility has become finding resources in order to "attract outstanding (and expensive) scholars," build new facilities, and improve student services." BOK, *supra* note 5, at 186. Moreover, the induced intercollegiate competition for dominance, influence, and reputation has forced institutions to use greater efforts and expand more funds in order to reach these goals. *Id.* at 14. A persistent race for prestige was amplified by the annual ranking published in *U.S. News & World Report. Id.*

Consequently, most schools are not "neutral institutions [anymore] that transmit skills and intellectual knowledge." ARONOWITZ, *supra* note 20, at 3. Instead, "[s]chools rob students of their individuality and . . . train kids to become cogs in the *corporate capitalism machine*." *Id.* (emphasis added).

21. BOK, *supra* note 5, at 12-13.

22. *Id.* at 13.

23. 35 U.S.C. § 200 (2006):

> It is the policy and objective of the Congress to use the patent system to promote the utilization of inventions arising from federally supported research or development; to encourage maximum participation of small business firms in federally supported research and development efforts; to promote collaboration between commercial concerns and nonprofit organizations, including universities; to ensure that inventions made by nonprofit organizations and small business firms are used in a manner to promote free competition and enterprise without unduly encumbering future research and discovery; *to promote the commercialization* . . . .

Id. (emphasis added).

24. *Id.* § 202(a). Prior to the Bayh-Dole Act, private companies were hesitant to invest into publicly funded research because they did not retain an exclusive right to the subject inventions. The Bayh-Dole Act: The Next Twenty Five Years: Before the House Science and Technology Subcomm. on Technology and Innovation (Submitted Aug. 27, 2007) (Statement of the Biotechnology Industry Organization), *available at* http://www.bio.org/ip/action/20070827.pdf. It was the government that owned all rights to the federally financed inventions, offering only outbound nonexclusive licenses. *Id.* Naturally, there was no incentive for the private sector to invest because the companies would be undertaking the substantial financial risk of developing a product. *Id.*

25. Risa L. Lieberwitz, *The Marketing of Higher Education: The Price of the University's Soul*, 89 CORNELL L. REV. 763, 780-81 (2004) (reviewing DEREK

was to encourage participation of businesses in academic research as well as to stimulate cooperation between commercial entities and, among others, universities.[26] Consequently, this promoted explicit and incredibly uncompromising commercialization.[27]

Again, the magnetism of money proves to be pervasive: the impact of the Act has been staggering. In the fiscal year 2000, universities filed 8,534 patents—a 300% increase from 1980; royalties increased by 520%.[28] By the end of year 2005, a total of 48,612 utility patents were granted to U.S. colleges and universities.[29] This number does not even include those patent applications that were filed but never issued, which constitutes approximately 25% of the total patent count (about 12,120 patent filings).[30] According to the 2009 Boliven Patent Report, the top twenty-five universities-assignees obtained about 1,883 patents in 2008 alone.[31] Further, in 2009, even in this global economic crisis, U.S. universities experienced an increase in patenting of 4% compared to 2008.[32] It follows that the Act launched aggressive corporate involvement in universities through funding of specific programs and entire departments.[33] Particularly, corporate funding of academic research increased by 93% within the four years subsequent to the Act.[34]

BOK, UNIVERSITIES IN THE MARKETPLACE: THE COMMERCIALIZATION OF HIGHER EDUCATION (2003)).

26. *Id.*; 35 U.S.C. § 200 (2006).

27. *See, e.g.*, Lieberwitz, *supra* note 25, at 780-81 (emphasizing the impact of The Bayh-Dole Act).

28. In 1979, before The Bayh-Dole Act, universities obtained only 264 patents. *Id.* In contrast, in 1997, universities obtained 2,436 patents. *Id.* In 1999, universities applied for approximately 7,510 patents. *Id.* In 2000, universities applied for 8,534 patents. *Id.*

29. U.S. TRADEMARK AND PATENT OFFICE, U.S. COLLEGES AND UNIVERSITIES—UTILITY PATENT GRANTS, CALENDAR YEARS 1969-2005, http://www.uspto.gov/web/offices/ac/ido/oeip/taf/univ/cls_gr/all_univ_clg.htm (updated in 2006) (as of October 2009, the last updated report available from the U.S. Trademark and Patent Office).

30. *Id.* (follow "Explanation of Data" link).

31. BILIVEN PATENTS TOP 25, INNOVATIONS AND PATENT LEADERS IN THE U.S. FOR 2008, at 4, http://www.boliven.com/news/Boliven_Patents_Top_25_2008.pdf.

32. Scott Oldach, *The Universities Patent Scorecard—2009 University Leaders in Innovations*, INTELL. PROP. TODAY, *available at* http://www.iptoday.com/articles/2009-9-oldach.asp.

33. Lieberwitz, *supra* note 25, at 780.

34. *Id.* at 781.

1. *Agreements Between Schools and Private Corporations: The "Knowledge Factories"*[35] *in Action*

Profits and governmentally granted power over inventions lured industry magnates into long-term agreements with research-leading universities.[36] In 1974, Harvard Medical School signed an agreement with Monsanto for $23.5 million for the exclusive license worldwide in the event of a discovery of a substance that would fight tumors.[37] In 1982, Harvard-affiliated Massachusetts General Hospital ("MGH") entered into a ten-year agreement for $70 million with Germany's Hoechst Corporation to fund the genetics department in return for the right of the German Corporation to have four of its scientists present on the premises of the department at any time.[38]

Further, the University of Connecticut signed a contract with Pfizer, a large pharmaceutical company, under which Pfizer agreed to build a $19 million research center on its campus.[39] Unfortunately, pursuant to the agreement, the university got to occupy only 20% of the premises, leaving 80% to the Pfizer laboratory.[40] In a joint venture, Harvard and MGH accepted an $85-million offer from Shiseido Company[41] for the exclusive right to sell health and beauty products developed by scientists at

35. BOK, *supra* note 5, at 16 (using the "knowledge factories" expression as a metaphor for elite schools that enjoy the interest of industry). *See generally* ARONOWITZ, *supra* note 20 (exploring the meaning of higher education as a "knowledge factory" for its students through historical and sociological perspective).

36. Lieberwitz, *supra* note 25, at 780-89.

37. John Trumpbour, *The Business-University Revisited: Industry and Empire in Crimson Cambridge*, *in* HOW HARVARD RULES 141, 154 (1989). A similar agreement was reached between Washington University and Monsanto for $23.5 million for the Biomedical Department in exchange for the exclusive licensing rights to possible patents. Lieberwitz, *supra* note 25, at 788. In 1998, Berkeley University executed an agreement with Novartis for $25 million, payable over five years, to fund the Department of Plant and Microbial Biology in exchange for the exclusive licensing to almost one-third of the total Department's discoveries. *Id.*

38. Trumpbour, *supra* note 37, at 154. The agreement between MGH and Hoechst further reads: "The right to have four of its [Hoechst's] scientists in the department at any one time . . . all manuscripts [must be read by the corporate representatives] thirty days before submission to a journal . . . access [will be granted] to the postdoctoral and graduate researches in Goodman's laboratory and in the hospital in general." *Id.*

39. William H. Honan, *Corporations Still Give, but Also Get*, N.Y. TIMES, July 15, 1998, at B9.

40. *Id.*

41. Steven R. Weisman, *Harvard and Japanese in Skin Research Deal*, N.Y. TIMES, Aug. 4, 1989, at A8. The Shiseido Company is Japan's leading cosmetic company with a world recognized medical institute. *Id.* Furthermore, it is among the world's leading companies with sales of over $3 billion a year. *Id.*

Harvard.[42] In 2007, Berkeley signed a ten-year contract with BP, establishing an Energy Bioscience Institute with the purpose of developing safer biofuels and discovering alternative energy, the "nation's biggest university-industry energy research project" worth $500 million.[43] Some claim that this pact is nothing more than "a new twist in the combination of debunked science, ecological imperialism, and the sophistry of 'sustainable development.'"[44] Overall, there are countless analogous agreements in force.[45] In fact, nowadays, this practice is deemed usual and even expected.[46]

2. *Strictly Profit-Generating Agreements: Aggressive Marketing and no Education Attached*

There are significant criticisms[47] and obvious flaws[48] in the

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42. *Id.*

43. Charles Burress, *UC Berkeley BP Finally Sign Contract for Research Project: Critics Assail Board for Giving Oil Firm Equal Membership,* SFGATE.COM, Nov. 15, 2007, http://articles.sfgate.com/2007-11-15/bay-area/17268477_1_uc-berkeley-oil-giant-bp-energy-biosciences-institute. *See also* Hannah Holleman & Rebecca Clausen, *Biofuels, BP-Berkeley, and the New Ecological Imperialism,* MONTHLY REV., Jan. 1, 2008, http://www.monthlyreview.org/mrzine/hc160108.html (the authors are two doctoral students, claiming that "BP appropriates academic expertise from a leading public research institution, founded on 200 years of social support, to maximize its return on energy investments.").

44. Holleman & Clausen, *supra* note 43.

45. *See* JENNIFER WASHBURN, UNIVERSITY INC.: THE CORPORATE CORRUPTION OF HIGHER EDUCATION 5 (2005) (describing an analogous multi-million-dollar agreement between Columbia University and Bristol-Myers as well as many other similar agreements); *see also* Weisman, *supra* note 41 (observing that from 1982 to 1989, Massachusetts General Hospital, which is in a commercial and academic joint venture with Harvard, had executed on average forty to fifty contracts with different corporations, each resulting in tremendous commercial benefits).

46. BOK, *supra* note 5, at 13. The corporate involvement and funding of the universities' research programs and departments have partially relieved the federal government from the burden of financing this sphere. *Id.* at 15. In fact, government is content with such developments and encourages collaboration between private corporations and not-for-profit universities: in lieu of such duty-sharing conduct, government grants tax incentives to the corporate donors. *Id.* at 11-12. The reason behind these governmental actions is clear: although the federal government still funds academic research, its share has dropped from a high of 73.5% in 1966 to below 60% today. WASHBURN, *supra* note 45, at 8. Specifically, in 2003, the federal government invested $21 billion in academic research. *Id.* Governmental support of commercialization is especially evident and, in fact, explicit in its legislation. *See supra* note 23 and accompanying text (quoting and discussing The Bayh-Dole Act).

47. It is important to note an ever-increasing concern as to the detrimental impact of the phenomenon of commercialization on the morality and quality of education per se. *See* BOK, *supra* note 5, at 208 (predicting inevitable and irreversible damage to academic values, standards, and integrity if excessive

strictly profit-generating agreements, which are an instrumentality in the accumulation of universities' wealth. Nonetheless, these agreements contribute to the advancement of research technology, to the enticement of the most qualified scholars, and to the actual substance of research. Hence, from one perspective, science benefits from the interests and involvement of the industry in the "knowledge factories."[49]

Conversely, there are agreements between universities and manufacturers or service providers entered into for the sole purpose of obtaining profits from the marketing transactions. For instance, California State University at Fresno negotiated an agreement with Pepsi-Cola and Save Mart for $40 million dollars for campus construction in exchange for the exclusive right to serve foods and beverages on its campus.[50]

The University of Minnesota entered into an exclusive agreement with TCF Bank for $40 million.[51] In exchange, TCF

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commercialization is tolerated any longer on the campuses of private schools). "In exchange for ephemeral gains in the continuing struggle for progress and prestige, they will have sacrificed essential values that are all but impossible to restore." *Id.*; *see also* WASHBURN, *supra* note 45, at 230-42 (claiming that the industry puts constraints on the freedom of the universities' actions and research, and the academic-commercial blend distracts schools from exploring ideas that have no apparent and immediate pecuniary value). "Education is justified apologetically as a useful instrument in attaining *other* ends: it is good for business or professional careers . . . . Rarely, however, does anyone presume to say that it is good for man." *Id.* at 240 (quoting historian Richard Hofstadter); *see also* Lieberwitz, *supra* note 25, at 798–99 (assuring that any extent of commercialization of academia is a crisis for higher education, resulting in damage to the well-internalized academic values and missions to serve the public).

48. *See* discussion *infra* Part III (analyzing the flaws of commercialization in regard to public taxation as well as direct conflicts between taxation policies and commercialization processes).

49. BOK, *supra* note 5, at 16. Many professors, however, complain about the commercialization of universities by claiming that higher educational institutions turned into "knowledge factories" or "learning enterprises." *Id.*

50. Honan, *supra* note 39. A similar agreement was signed by the Pepsi-Cola Company and Pennsylvania State University for $14 million for the exclusive rights to sell its products on twenty-one university campuses. *Id.*

Until recently, New York University had on its premises more than eighty-six Coca-Cola vending machines. Elizabeth Woyke, *How NYU Chose Colombia over Coke*, BUS. WK., Jan. 23, 2006, *available at* http://www.businessweek.com/magazine/content/06_04/b3968078.htm. During the interview, the spokesperson for New York University did not know the value of the deal with Coca-Cola. *Id.* But he admitted that the "public-relations hit of losing such a trend-setting school might make any executive wince." *Id.*

51. Dean Foust, *Even Cozier Deals on Campus: Joining Forces with Banks, Colleges Are Now Cashing in on Student Debit Cards*, BUS. WK., Oct. 1, 2007, *available at* http://www.businessweek.com/magazine/content/07_40/b4052059.htm?chan=bschools_undergraduate+business+programs+--+new+design_school+life.

Bank attached debit and ATM features to students' ID cards.[52] TCF has identical arrangements with nine other schools, including the University of Michigan.[53] Similarly, Higher One[54] engages in analogous marketing behavior, advancing to schools 0.08% of all off-campus student purchases, made using Higher One's debit cards.[55] Presently, seventeen schools have executed identical agreements with Higher One.[56] Furthermore, universities employ aggressive marketing techniques to promote and profit from their school logos.[57] Similar to Chanel and Dior, universities such as Oxford, Harvard, Yale, New York University, etc. have become "couture" in the sphere of education. Above all is Harvard, regarded as "the best brand in higher education."[58]

In brief, the market economy is nurturing a symbiotic relationship between academia and industry. Especially now, in 2009,—in the midst of an economic downfall—for banks and elite schools, the aforementioned agreements are golden opportunities.[59] For banks, they are a marketing highway;[60] for

52. *Id.* Under the exclusive agreement with TCF Bank, a fifteen-billion-dollar enterprise, the University of Minnesota issued to 52,000 of its students the new identification cards containing ATM features. *Id.* In aggregate, this massive use of TCF ATMs by students has transferred $50 million dollars into TCF Bank accounts. *Id.*; *see also* Jonathan D. Glater, *The Debt Trap: Colleges Profit as Banks Market Credit Cards to Students*, N.Y. TIMES, Jan. 1, 2009, at B1 (discussing many other analogous agreements between colleges and credit card companies as well as their negative impact on the future of the students in the United States).

53. Foust, *supra* note 51. Such contracts give the bank a prospect to recruit a future generation of customers by monopolizing the educational sphere through its marketing. *Id.* For years now, US Bancorp, Bank of America, and Wells Fargo have been assessing the fields of potential invasion into the universities' student body. *Id.*

54. *Id.* Higher One Inc. was founded by three Yale University undergraduates. *Id.* The company, among other functions, disburses financial aid and other payments from schools to students. *Id.* It also provides ATM cards to students through school identification cards. *Id.*

55. *Id.*

56. *Id.*

57. BOK, *supra* note 5, at 13. Business offices license the use of the universities' names in order to put them on sweatshirts, mugs, and other paraphernalia and sell them at the boutiques on campuses or at the campus bookstores. *Id.* This technique proved to be of great significance in raising revenue to such an extent that universities' bookstores give better shelving to trifling memorabilia than to academic publications. Willis G. Regier, *Profit or Perish: Today's University Presses*, AM. ACAD., June 7, 2004, at 114, *available at* http://www.aft.org/pubs-reports/american_academic/issues/june04/Regier.qxp.pdf.

58. RICHARD BRADLEY, HARVARD RULES: THE STRUGGLE FOR THE SOUL OF THE WORLD'S MOST POWERFUL UNIVERSITY, at xix (2005).

59. Glater, *supra* note 52.

60. *Id.*

universities, they are a source of revenue;[61] for students, unfortunately, they are the beginning of debt entrapment.

3. *Private Donations as a Source of Endowments: Infatuation with Generosity*

"[W]ith all my worldly goods I thee endow . . . and all that I have I share with you."[62]

In the last decades, universities have been experiencing a great influx of endowments.[63] For instance, in 2006, a combined amount of endowments[64] reached $340 billion.[65] This astonishing number is a product of generosity of people such as Eli and Edythe Broad.[66] They donated $400 million[67] to the Genetics Institute.[68] Their donation has been managed by Harvard University with the aim of turning it into a one-billion-dollar endowment, which would render this research center one of the wealthiest in the world.[69]

In order to manage its donations, each elite school has a separate investment group. For instance, the Yale Corporation

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61. *Id.*

62. *Solemnization of Matrimony Wedding*, THE BOOK OF COMMON PRAYER 190 (1662).

63. Mark J. Cowan, *Taxing and Regulating College and University Endowment Income: The Literature's Perspective*, 34 J.C. & U.L 507, 507 (2008).

64. The legal definition of endowment is "a gift of money or property to an institution for a specific purpose, esp[ecially] one in which the principal is kept intact indefinitely and only the interest income from that principal is used." BLACK'S LAW DICTIONARY 569 (8th ed. 2004). However, when universities, Congress, or any other nonlegal entity or person refers to endowments, they generally speak of the institution's total funds, without taking into consideration any implications of the restrictions on their use. Cowan, *supra* note 63, at 522. In this Comment, the latter meaning is used.

65. Cowan, *supra* note 63, at 507.

66. Eli and Edythe Broad are real estate and insurance multibillionaires. Stephanie Strom, *$400 Million Gift to Genetic Institute*, N.Y. TIMES, Sept. 5, 2008, at A18. It is a story about one of the largest donations to the Broad Institute of the Massachusetts Institute of Technology and Harvard in the amount of $400 million. *Id.*

Those colossal donations are the creation of the social reformers that entered progressing academic social science research at the end of the nineteenth century. Lieberwitz, *Distance Learning*, *supra* note 5, at 78. For instance, the founder of Standard Oil Company contributed $34 million to the University of Chicago; the West Coast railroad industrialist Leland Stanford donated $24 million to Leland Stanford Junior University as his testamentary wish. *Id.*

67. Strom, *supra* note 66.

68. *Id.* The Genetics Institute works on the research of genetic links to major illnesses and molecular causes of illnesses; these discoveries are directed at new ways of diagnosing and preventing illnesses as well as developing preventive medicines. *Id.*

69. *Id.*

Investment Committee has been managing Yale's endowments since 1975.[70] In 2007, it generated $22.5 billion with a record-setting $5.0 billion in investment gains.[71] In addition to having its assets in domestic equity, Yale diversified its portfolio by investing in foreign markets.[72] Similarly, Harvard Management Company had another—and the last up to date—prolific investment year in 2007 with the end result of $41 billion;[73] the investment returns were 17.7%, which translated into $1.9 billion.[74] The runner-ups in this contest were Stanford University with over $17 billion and Princeton with almost $16 billion.[75]

Unfortunately, the economic downfall of 2008 and 2009 negatively affected the amount of accumulated endowments and investment returns held by higher education. Specifically, universities suffer losses in the value of illiquid private equity and real estate investments, experience substantial budget reductions as well as spending restraints, and foresee future hiring reductions.[76] On average, the decrease in endowment value constitutes about 25% to 30%.[77] But schools still report "generated solid relative results" as compared to the overall economic plummeting.[78] Some even question whether it is an "accurate way

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70. YALE UNIV., THE YALE ENDOWMENT 23 (2007).

71. *Id.* at 2. Over the period of ten years, Yale's endowments grew from $5.8 billion to $22.5 billion. *Id.* The investment gain is 28%. *Id.* Only in the fiscal year ending June 30, 2009, the endowment value fell to $16.3 billion. YALE UNIVERSITY OFFICE OF PUBLIC AFFAIRS, YALE UNIVERSITY RELEASES ENDOWMENT FIGURES (Sept. 22, 2009), http://opa.yale.edu/news/article.aspx?id=6899.

72. Joseph Nocera, *No, You Can't Invest Like Yale. Sorry!*, N.Y. TIMES, Aug. 13, 2005, at C1.

73. HARVARD MGMT. CO., HARVARD UNIV., ANNUAL FIN. REPORT OF HARVARD UNIV. (2007), *available at* http://www.vpf-web.harvard.edu/annualfinancial/pdfs/2007fullreport.pdf.

74. *Id.*

75. NATIONAL ASSOCIATION OF COLLEGE AND UNIVERSITY BUSINESS OFFICERS, 2007 ENDOWMENT STUDY (2008) [hereinafter ENDOWMENT STUDY], *available at* http://www.nacubo.org (go to "Research" link, then "NACUBO Endowment Study," then click on "Public NES Tables" link, and then choose year 2007).

76. *Yale Capitulates*, HARV. MAG., Sept. 11, 2009, http://harvardmagazine.com/breaking-news/yale-endowment-losses-spending-cuts.

77. *Id.* President of Yale Richard C. Levin announced that the school anticipates a decline in its endowment by about $6 billion. *Id.* Harvard may experience a 29.5% decline in its endowment fund. *Id.* *See also* Geraldine Fabrikant, *Yale's Endowment Drops 13.4%*, N.Y. TIMES, Dec. 16, 2008, at B3 (covering the decrease in Yale's endowment and other financial effects of the declining economy in 2008).

78. *See, e.g.*, YALE UNIVERSITY, THE YALE ENDOWMENT 2 (2008). *See also* (claiming that despite the losses, Harvard, for instance, will still remain the richest university in the world). Charlotte Allen, *Commentary, How Harvard Should Handle Its Endowment: Look to the Great Depression, When the University Effectively Managed Its Assets*, FORBES.COM, Feb. 27, 2009,

to characterize" the current schools' crises as "worst economic crisis since the Great Depression."[79] The numerical results do not mean, however, that schools chose not to engage in corporate behavior. In fact, the economic crisis makes private and public universities and colleges develop and employ even more aggressive commercial strategies.[80]

B. Tax Code, Large Endowments, and Devaluation of Education: Fatal Love Triangle

"To tax and to please, no more than to love and to be wise, is not given to men."[81]

It is obvious that higher education focuses on remunerative activities, departing from its original mission.[82] This monetary determinism is seen in the development of distance learning[83] as well as in the declining interest and budget reduction for philosophy, religion, creative writing, and such other disciplines that are not revenue generating apparatuses or industry-attracting programs.[84] This trend is also evidenced by a change in

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http://www.forbes.com/2009/02/27/harvard-endowment-depression-opinions-contributors_harvard.html.

79. Allen, *supra* note 78.

80. For example, in *Calendar-Year 2008 Update on Endowment Performance*, Yale reported, "While the decline in Endowment value in the current financial crisis caused some observers to question the tenants of Yale's investment strategy, when evaluated with a time horizon appropriate for a long-term investor, the University's equity-oriented, well-diversified portfolio continues to provide the best foundation for future investment success." YALE UNIVERSITY, *supra* note 78, at 3.

81. Edmund Burke, Esq., Speech on American Taxation (Apr. 19, 1774) *in* SELECT WORKS OF EDMUND BURKE 149 (London: J. Dodsley 2nd ed. 1775), *available at* http://www.econlib.org/library/LFBooks/Burke?brkSWv1c2.html.

82. WASHBURN, *supra* note 45, at 205 (alleging that the schools' original mission to serve academic disciplines and public good is substituted by the mission to generate profits).

83. Lieberwitz, *Distance Learning*, *supra* note 5, at 104. The creation and promotion of profit-generating Internet-based distance-learning programs in private schools is a sign of advanced corporatization. *Id.* Universities tend to develop such distance-learning programs in a for-profit sector. *Id.* An illustrative example of such development is partnerships between private sector universities and for-profit corporations. *Id.* One of them is a partnership between the for-profit UNext.com and the University of Chicago, Columbia University, Stanford University, Carnegie Mellon University, and the London School of Economics. *Id.* Another type of commercial arrangement is E-Cornell, a for-profit subsidiary of Cornell University. *Id.* The most astounding news is that the universities that have such wholly-owned for-profit subsidiaries of distance-learning expressed their intentions to sell equity in the corporations in order to seek investment capital and thus realize large profits. *Id.* at 106.

84. *Id.* Professors of English must demonstrate that they are capable of raising funds like the engineering or business departments can. *Id.*

the policy-making processes: until thirty years ago, professoriate and researchers in the psychology field had been developing education policy.[85] But in the modern days of twenty-first century, economists are deciding the education policy issues by performing cost-benefit analyses of investments, by examining their intended as well as unintended consequences, and by implementing techniques and methodologies employed in economic studies.[86] Indeed, schools define their success in strict quantifiable productivity units.[87] Even presidents,[88] deans, and administrators[89] are hired for their fundraising abilities[90] and for

Literature lost its importance and appeal, giving way to "technoscience" and thereby complying with the needs of modern society. ARONOWITZ, *supra* note 20, at 4-5. In fact, "the social sciences have increasingly veered toward the natural sciences in their self-conscious subordination to the prevailing order" that is following the money. *Id.* at 4.

85. David McKay Wilson, *The Invisible Hand in Education Policy: Behind the Scenes, Economists Wield Unprecedented Influence*, HARV. EDUC. LETTER, Vol. 25, No. 5, Sept./ Oct. 2009, *available at* http://www.hepg.org/hel/article/ 421 (partial access without subscription).

86. *Id.*; *see also* Sarah E. Waldeck, *The Coming Showdown over University Endowments: Enlisting the Donors*, 77 FORDHAM L. REV. 1795, 1805 (2009) ("spending discretion" will cause "'mission drift'"—"key decisions will be made by a powerful few instead of being painstakingly hammered out by faculty . . . .").

87. *See* BOK, *supra* note 5, at 15 (referring to the members of academia as enterprising leaders who seek to take advantage "of any legitimate opportunity that the commercial world had to offer").

88. A president of a higher education institution is labeled as a CEO. Rhoades & Slaughter, *supra* note 9, at 38–39. But in the corporate sector, the shareholders have a vote, at least in theory, with no such opportunity in tax-exempt educational sector.

89. *See* Nocera, *supra* note 72, at C1 (describing the credentials and accomplishments of a Yale graduate David Swensen who took over the Yale endowments after working on Wall Street). Under the leadership of Mr. Swensen, Yale generated $14 billion and earned 16.1% in annual investment returns. *Id.* The Yale portfolio transformed from a mere collection of stocks and bonds into a fully diversified portfolio, holding 15% of its assets in domestic equity, 15% in foreign stocks, and 26% in hedge funds. *Id.*

90. WASHBURN, *supra* note 45, at 206-07. Administrators are hired on the basis of their connections with the corporate sector that may lead to possible investments as well as to significant increases in the school's prestige. *Id.* at 205. University presidents are recruited directly from industry for their corporate abilities and not for their actual knowledge of academia or educational experience. *Id.* In 2002, the average salary of a president of an elite school amounted to $800,000 with additional annual compensation of approximately $200,000 for serving on corporate boards. *Id.* In the 2006-2007 fiscal year, President of Emory University James W. Wagner received $1.04 million in compensation. Tiffany Han, *Wagner's Salary Ranks in Top 10*, EMORYWHEEL.COM, Nov. 24, 2008, http://www.emorywheel.com/detail.php?n= 26297. The itemization shows: "base salary of $700,000, $125,000 in deferred compensation and $43,000 as a retirement-plan distribution. Benefits of $172,220—an incentive for retention—and an expense of account of $55,312 . . . ." *Id.* In 2008, Shirley Ann Jackson at Rensselaer Polytechnic Institute in

being "enterprising leaders."[91] In fact, one Harvard dean would manage to break away from his full-time tenure to be on the Citigroup board.[92]

A study[93] released on August 6, 2008, prepared by the National Association of College and University Business Officers[94] ("NACUBO"), revealed that 785 colleges and universities accumulated over $411 billion in endowment assets.[95] On average, in a good economy, universities earn 17.2% on their endowments, which translates into $70.7 billion in generated profits.[96] The study released in January 2009 revealed that even in the economic crises with lower (and sometimes negative) returns, 796 colleges and universities accumulated over $412 billion in endowments.[97] Consistent with the universities' tax-exempt status,[98] a large portion of the $411 billion has not been subjected to the federal income tax. Therefore, the federal government lost $23.3 billion in taxes due to the tax-exempt status of schools.[99] Furthermore, this

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New York received compensation of $1.6 million. Justine Pope, *Private College Salaries of More than $1 Million Paid to 23 Presidents,* THE HUFFINGTON POST, Jan. 11, 2009, *available at* http://www.huffingtonpost.com/2009/11/02/private-college-salaries-_n_341777.html.

91. WASHBURN, *supra* note 45, at 206-07.

92. *See* Eric Dash, *Dean of Harvard Business School May Join Citigroup's Board*, N.Y. TIMES, July 9, 2008, at C2 (informing that Citigroup, after searching for directors with outstanding financial expertise, is close to recruiting Jay O. Light, an expert in asset management, Dean of the Harvard Business School, and a director of the Harvard Management Company). Light is an expert in global investment management and in structuring complex financial transactions. *Id.* The executive recruiters admitted that it had been tremendously difficult to find a candidate with "strong financial acumen" and willingness "to put in hours necessary to sit on a risk committee." *Id.*

93. The 2007 NACUBO Endowment Study covers the most relevant information on endowments and their management through the end of 2007 fiscal year. ENDOWMENT STUDY, *supra* note 75.

94. The National Association of College and University Business Officers is a non-profit group representing financial officers in higher education. Mary Beth Marklein, *Return on College Endowments Rises for Third Straight Year*, USA TODAY, Jan. 10, 2007, at 7D.

95. ENDOWMENT STUDY, *supra* note 75.

96. *Cf.* Goldie Blumenstyk, *Endowments Savor Big Gains but Lower Their Sights*, THE CHRON. OF HIGHER EDUC. (WASH. D.C.), Feb. 1, 2008, at A1.

97. NATIONAL ASSOCIATION OF COLLEGE AND UNIVERSITY BUSINESS OFFICERS, 2008 ENDOWMENT STUDY (2009), *available at* http://www.nacubo.org/Research/NACUBO_Endowment_Study.html.

98. *See* discussion *infra* Part III (analyzing in depth a tax-exempt status of schools and its obsolete functions).

99. *See also* Cowan, *supra* note 63, at 507 (presenting statistics as to endowments for the fiscal year that ended in June 2006). Specifically, in 2006, 765 institutions reported a total of $340 billion in endowment assets that generated 15.5% of profits, which equates to $52 billion. *Id.* Since this income is not taxable, the federal government lost approximately $18 billion in taxes. *Id.* In addition, because a major part of endowments is a result of charitable contributions, the federal government suffered about $6.6 billion in revenue

number does not take into account the forgone tax revenue as a result of the deductions for charitable contributions to educational institutions by taxpayers-donors.[100]

Despite the flourishing academic capitalism,[101] elite schools still enjoy the privilege of tax exemption. Indeed, there have been drastic deviations from tradition, defined by the schools' blatant corporate ideology and entrepreneurial behavior as well as by their failure to carry on the original mission of education. Hence, these changes should affect existing tax law, at least to some degree.

III. ANALYSIS

It is evident the traditional perception of universities is misleading and archaic — corporate philosophy has leaked into the schools' ideology, influencing the governance of the universities, the purported public mission, and the basic social ideals of schools.[102] Moreover, it is partially abusive[103]—private schools have lost their unique trait of a non-profit institution by changing their identities toward the corporate paradigm, but they still maintain their tax-exempt status. In order to adapt the existing tax law to the realities of the global economy, a detailed analysis of the original tax-exempt purposes in conjunction with the changed economic realities of schools is necessary. This analysis will demonstrate that the new economic realities of schools extinguished the applicability of the originally thought rationales for their exemptions.

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loss from the deductions for charitable contributions to schools. *Id. See also* Marklein, *supra* note 94, at 7D (reporting the 2006 NACUBO's financial findings on endowments and their returns).

100. *See* Cowan, *supra* note 63, at 507, 553 n.6 (referring to the congressional projections as to the lost revenue in 2007).

101. Rhoades & Slaughter, *supra* note 9, at 37. The author defines "academic capitalism" as an engagement of higher education institutions and their faculties in market-like behaviors. *Id.* This behavior is a consequence of the global economy and the interactions among economy, leading schools, and industry. *Id.* at 38.

102. Lieberwitz, *Distance Learning, supra* note 5, at 129 (claiming that corporatization trends have been altering universities' identity).

103. *See, e.g.*, John M. Bello, *Economics 101: A Study of the Tax-Exempt Status of Colleges and Universities*, 34 SUFFOLK U. L. REV. 615, 626 (2001) (stating that exemptions of the universities shift the burden to the taxpayers).

A. Original Purpose of Tax Exemption to Help the Needy: "Epiphenomenal Afterthought"[104]

The concept of tax exemption[105] was incorporated into the first tax code ever adopted.[106] In 1894, Congress passed the first corporate income tax law,[107] exempting schools from the federal income tax.[108] Despite the codified exemptions, the purpose was not clear because the "exemption more or less just happened without a great deal of thought regarding why we hand out tax exemption."[109] This automatic status was expected because when Congress enacted the first corporate income tax law, private schools, churches, and other similarly situated organizations were already exempt from state property taxes.[110] Moreover, these organizations were clearly not businesses; thus, the exemptions were incorporated in the newly created federal income tax law[111]

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104. Joseph J. Thorndike, *The Origins of the American Income Tax: The Revenue Act of 1894 and Its Aftermath*, TAX ANALYSTS, May 30, 2005, at 1182 (reviewing RICHARD J. JOSEPH, THE ORIGINS OF THE AMERICAN INCOME TAX: THE REVENUE ACT OF 1894 AND ITS AFTERMATH (Syracuse Univ. Press 2004)).

"Epiphenomenal" stems from "epiphenomenon" that means "a secondary symptom, which may occur simultaneously with a disease [or immediately thereafter] etc. but is not regarded as its cause or result." OXFORD ENGLISH REFERENCE DICTIONARY 473 (Judy Pearsall & Bill Trumble eds., rev. 2d ed. 2002) [hereinafter DICTIONARY].

105. The concept of tax exemption was borrowed from the British traditions. Lynn Lu, *Flunking the Methodology Test: A Flawed Tax-Exemption Standard for Educational Organizations that "Advoate[] a Particular Position of Viewpoint,"* 29 N.Y.U. REV. L. & SOC. CHANGE 377, 380 (2004). It mimicked British charitable trust law that recognized the validity of trusts established for the benefit of "'schools of learning' and for the 'advancement of education.'" *Id.*

106. Henry Hansmann, *The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation*, 91 YALE L.J. 54, 54 (1981).

107. *See generally Decided on an Income Tax; The Committee Sees no Way to Avoid Its Imposition*, N.Y. TIMES (ARCHIVES), Jan. 3, 1894, at 1 (discussing in detail the debate over the imposition of taxation); *Details on the Income Tax; The Internal Revenue Bills as Finally Completed*, N.Y. TIMES (ARCHIVES), Jan. 23, 1894, at 3 (reporting a newly enacted law that imposed a tax on corporate and individual incomes and including the full text of the important sections).

108. *Historical Development and Present Law of the Federal Tax Exemption for Charities and Other Tax-Exempt Organizations: Public Hearing Before the H. Comm. on Ways and Means*, 109th Cong. 2 (Apr. 20, 2005), 2005 WL 5783678 [hereinafter *Public Hearing*].

109. John D. Colombo, Professor of Law, Testimony on Tax-Exempt Sector: 501(C) Organizations before Comm. on House Ways and Means (Apr. 20, 2005) [hereinafter Testimony]. *See also* John D. Colombo, *Why Is Harvard Tax-Exempt? (And Other Mysteries of Tax Exemption for Private Educational Institutions)*, 35 ARIZ. L. REV. 841, 844-45 (1993) (elaborating on the historical origins of tax exemptions and, in particular, on the impact of the 1984 legislation).

110. Testimony, *supra* note 109.

111. The Tariff Act of 1894 provided the first codification of federal income tax exemption status for charitable organizations. *Public Hearing*, *supra* note

by default and without much debate.[112] Therefore, at the inception of exemption law, there was no verbalized legislative history or rationale as to the particularities of exemptions and, specifically, as to what organizational behaviors should be exempt.[113]

The *extracted* underlying rational of the 1894 tax law seems to be to tax the "ability to pay" or the value of the received benefits.[114] As a result, the legislature accepted such rational for the subsequent codifications of exemptions.[115] The derived presumption, therefore, is that schools have no ability to pay or receive monetary benefits. Despite the fact that the corporate income tax of 1894 was a "stillborn" legislation,[116] its ideology affected all subsequent tax legislation,[117] including the modern tax law. The current codification is section 501(c)(3) of the Internal Revenue Code, which extends exemptions to organizations that provide educational services.[118] By implication, schools have retained this stigma of "poor" and, thus, their exempt status for the past one hundred and sixteen years.

108, at 2. "[N]othing herein contained shall apply to --- corporations, companies, or associations organized and conducted solely for charitable, religious, or educational purposes." *Id.*

112. Testimony, *supra* note 109.

113. *Id.*

114. RICHARD J. JOSEPH, THE ORIGINS OF THE AMERICAN INCOME TAX: THE REVENUE ACT OF 1894 AND ITS AFTERMATH 89-90 (Syracuse Univ. Press 2004) (asserting that the "[a]bility to pay is nearly synonymous with revenue"). In a perfect system of equity, each citizen and entity contributes to the support of the national government based on financial ability. *Id.* at 89. Such a system of equity can only be achieved through taxation. *Id.* at 89-90.

115. Colombo, *supra* note 109, at 845.

116. Thorndike, *supra* note 104, at 1181.

117. It is important to note that one year after its adoption, the tax law of 1894 was repealed by the Supreme Court in *Pollock v. Farmers' Loan and Trust Co.* JOSEPH, *supra* note 114, at 105-15. But the income tax of 1894 is the source of "the sociopolitical origins of the modern tax regime." Thorndike, *supra* note 104, at 1181. Additionally, the income tax of 1894 became the model for later tax legislation. *Id.* Particularly, the drafters of the 1913 income tax were substantially deferential to the 1894 legislation. W. Elliot Brownlee, *Review of Richard J. Joseph, The Origins of the American Income Tax: The Revenue Act of 1894 and Its Aftermath*, ECON. HIST. SERVICES, Sept. 28, 2004, http://www.eh.net/bookreviews/library/0851.

118. I.R.C. § 501(c)(3) (2006); Treas. Reg. § 1.501(c)(3)-1(d)(3) (as amended in 2008):

> The term "educational," as used in section 501(c)(3), relates to: (a) the instruction or training of the individual for the purpose of improving or developing his capabilities; or (b) the instruction of the public on subjects useful to the individual and beneficial to the community. An organization may be educational even though it advocates a particular position or viewpoint so long as it presents a sufficiently full and fair exposition of the pertinent facts as to permit an individual or the public to form an independent opinion or conclusion. On the other hand, an organization is not educational if its principal function is the mere presentation of unsupported opinion.

1. *Irrelevancy of Original Purpose to Help: "Needy" Schools Blossom into Lucrative Enterprises*

The major justification for tax exemptions has been schools' inability to find capital[119] because they are prohibited from issuing shares of equity.[120] But this thinking is archaic as proven by commercialization processes. Schools have transformed from underfunded, unsophisticated institutions into lucrative enterprises with budgets amounting to billions of dollars.[121] Furthermore, schools create and directly own subsidiaries for the sole purpose of making profits on their investments,[122] allegedly, to fund academia. It is apparent that schools do not struggle anymore to obtain capital to support academic endeavors as in the past. In fact, the private sector's involvement in academic funding is a bright example thereof. Despite educational institutions' easy access to capital,[123] the law has not been adapted to new economic realities. Wealthy schools are still, almost fully,[124] exempt from taxation. In brief, the main purpose of the legislature to help the "needy" is archaic and irrelevant in the modern academic world.

Exemption from taxation is a method of *support* by the federal government. Undoubtedly, the government has a responsibility to contribute to education in order to *promote* it.[125] It is imperative to note, however, that the word "promote" is different from the word "support," used by the legislators and commentators in the past. Nowadays, "to promote" means simply to demonstrate the importance of academia and to encourage.[126] "To support" means to bear the burden of financing the academia.[127] Undeniably,

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119. This idea is called Capital Subsidy Theory, introduced by Professor Henry Hansmann. Colombo, *supra* note 109, at 868-71. Under this theory, one of the reasons universities are tax-exempt is their inability to access capital markets. *Id.* at 868. In other words, a university, as a non-profit organization, cannot issue shares to investors to obtain necessary capital. *Id.*

120. JOINT COMMITTEE ON TAXATION, 106TH CONG., STUDY OF PRESENT-LAW TAXPAYER CONFIDENTIALITY AND DISCLOSURE PROVISIONS AS REQUIRED BY SECTION 3802 OF THE IRS RESTRUCTURING AND REFORM ACT OF 1998 29 (Jan. 28, 2000), 2000 WL 35586674 [hereinafter STUDY].

121. *See supra* notes 70-74 and accompanying text (discussing the elite schools' budgets and their management).

122. *See supra* notes 70, 72-73, 81 (discussing schools' subsidiaries and investment management groups handling schools' endowment funds).

123. *See* discussion *supra* Part II (describing the processes of commercialization in the sphere of education).

124. It is imperative to note that the profit-seeking activities predominantly for educational purposes are not taxed; however, Congress imposes tax on the unrelated business income. I.R.C. §§ 511, 513 (2006).

125. *See* U.S. CONST. art. I, § 8, cl. 8 (granting Congress the power to promote science and the "useful arts").

126. See DICTIONARY, *supra* note 104, at 1156 (defining the word "promote" as to help forward, to encourage).

127. *See id.* at 1450 (defining the word "support" as to carry all or part of the

schools have great and continuous need for federal *promotion* (and *support*, in case of their failing). However, it appears higher education, especially elite schools, have no need for federal *support* as they have millions, and even billions, of dollars in revenues. Above all, this governmental support of universities through tax exemptions, unfortunately, is born in great part by the citizenry.[128]

2. *Unrelated Business Income Tax Law: Unsuccessful Attempt to Adapt Tax Law to Commercialized Realities*

As a response to commercialization processes and schools' fervent interest in maximizing their profits,[129] Congress enacted the Unrelated Business Income Tax Law[130] (hereinafter "Business Tax") in 1950. It came into effect as a limitation on tax exemptions with the purpose of curtailing substantial abuse of tax-exempt status by corporatized schools.[131]

Prior to 1950, schools had benefited from a total freedom from federal tax as long as they satisfied a statutory requirement of the "exclusive[132] [educational] purpose."[133] In other words, there was no statutorily mandated limitation on the amount or degree of business activities of schools if the profits from those activities were directed to the schools' exempt purposes.[134] In contrast, now

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weight; keep from falling or sinking or failing).

128. Bello, *supra* note 103, at 626. Schools' properties and real estate are, of course, tax exempt. *Id.* Hence, when schools expend or acquire new properties, the tax-paying sector is decreasing, or at least not growing. *Id.* Consequently, the individual taxpayers are responsible for balancing the forgone revenue due to tax exemptions and needed revenue.

129. BERTRAND M. HARDING, JR., THE TAX LAW OF COLLEGES AND UNIVERSITIES 11 (John Wiley & Sons 3d ed. 2007).

130. The Unrelated Business Income Tax Law is codified in sections 511 through 513 of the Internal Revenue Code. I.R.C. §§ 511-13 (2006).

131. Cowen, *supra* note 63, at 540; *see also* Sierra Club Inc. v. Comm'r, 86 F.3d 1526, 1532-35 (9th Cir. 1996) (applying Business Tax analysis to royalties, which were not determined to be an unrelated business income and thus excluded from taxation); Mark L. Gordon, *University Controlled or Owned Technology: The State of Commercialization and Recommendation*, 30 J.C. & U.L. 641, 664-65 (2004) (analyzing the application of the unrelated business income tax to the sphere of licensing and patenting in the age of continuous commercialization); I.R.S. Mem. on Exclusive Provider Arrangement and UBIT (Aug. 14, 2001) (on file with author), *available at* http://www.irs.treas.gov/pub/irs-tege/081401.pdf [hereinafter I.R.S. Memo] (explaining how to analyze exclusive provider agreements under Business Tax law).

132. "Exclusively" is not read in strict manner. *Description of Present Law Relating to Section 501(c)(3) Organizations and Summary of Sections 503(c)(3)—Related Provisions of the Pension Protection Act of 2006 and Proposed Legislative Proposals: Public Hearing Before the H. Comm. on Ways and Means Subcomm. on Oversight*, 110th Cong. 5 (July 24, 2007), 2007 WL 2774147 [hereinafter *Oversight*].

133. *Public Hearing*, *supra* note 108, at 35.

134. *Id.*

the law provides for the taxation of profits obtained from universities' business activities that are substantially unrelated to (or different from) their educational activities.[135] Such income is being taxed at the ordinary corporate rates.[136]

In addition to the general goal of eliminating abuse of a tax-exempt status by commercialized schools, Congress had two specific motivations in enacting the law.[137] First, Congress needed to eradicate unfair competition;[138] as both types of entities engage in analogous commercial dealings, Congress sought to equalize schools that enjoy exemptions and corporate businesses that bear the burden of taxation.[139] The reason being, exempt organizations use their untaxed profits to "expand [their] operations, while their [for profit] competitors can expand only with profits remaining after taxes."[140]

Second, the Internal Revenue Service wanted to avoid an unworkable process of revocation of the tax-exempt status from schools that engage in the noneducational business activities.[141] Specifically, instead of revoking their tax-exempt status, the IRS imposes a Business Tax (at corporate rate) on the schools' net income, derived from the noneducational business activities.[142] Moreover, this congressional move endeavored to increase federal

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135. I.R.C. §§ 511, 513; I.R.S., *Tax on Unrelated Business Income of Exempt Organizations*, PUBLICATION 598, Nov. 2007, at 2 [hereinafter PUBLICATION]. Unrelated business income is defined as the income from a trade or business regularly carried on by an exempt organization that "is not substantially related to the performance by the organization of its exempt purpose or function, except that the organization uses the profits derived from this activity." *Id.* The term "trade or business" includes any type of activities engaged in by an exempt institution for the production of income, including selling goods and performing services. *Id.* An activity is not substantially related to the organization's exempt purposes "if it does not contribute importantly to accomplishing that purpose" in addition to simply generating funds for the organization. *Id.*

136. *Public Hearing*, *supra* note 108, at 34.

137. HARDING, *supra* note 129, at 11-13.

138. BRUCE R. HOPKINS, THE LAW OF TAX-EXEMPT ORGANIZATIONS 720-21 (N.Y.: John Wiley & Sons 2007) (citing the Senate Committee on Finance that the "major purpose" of the restricting law is to ensure that exempt organizations do not "commercially exploit [their] status for the purpose of unfairly competing with taxpaying" businesses); *see also* H. REP. NO. 2319, at 36 (1950) (fostering the unrelated business income tax primarily to restrain the unfair competition).

139. HARDING, *supra* note 129, at 11; *see also* Rita Marie Cain, *Marketing Activities in the Nonprofits Sector—Recent Lessons Regarding Tax Implications*, 36 AM. BUS. L.J. 349, 350 (1998) (discussing the claim of unfair competition in the era of commercialization and the need for leveling the playing field).

140. HOPKINS, *supra* note 138, at 720 (quoting the Ways and Means Committee's report accompanying the Revenue Act of 1950).

141. HARDING, *supra* note 129, at 11; HOPKINS, *supra* note 138, at 720.

142. HARDING, *supra* note 129, at 11.

revenues by "eliminating tax loopholes."[143]

In 1969, the Tax Reform Act extended the applicability of the Business Tax to all tax-exempt organizations.[144] In subsequent years, Congress has been expanding the coverage of the Business Tax law by categorizing specific activities as unrelated to educational purposes and subjecting income from such activities to the Business Tax.[145] Repeatedly, courts find income from numerous activities to be taxable: revenue producing educational property, bookstores, stadiums, fraternities, radio, television,[146] soliciting, commercial advertising,[147] and many other activities. Most importantly, courts have granted citizens standing to sue schools (under specific circumstances) on the grounds that taxpayers should have the power to defend the public treasury.[148]

Upon reflection, the sixty-year-old history of the Business Tax law, with its continuous restricting tendencies, has produced a complicated and unclear test with nonuniform explanations.[149] Let us consider, for example, the exclusive provider agreement between California State University and Coca Cola, discussed in Part II. According to the Internal Revenue Service Memorandum,

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143. Allan Maram, Rapid Response Commentary, *Commercialization of the Nonprofit Sector: A Discussion and Critical Analysis*, SOC. & PUB. POL'Y REV., Vol. 2, No. 2 (2007), *available at* http://www.plymouth.ac.uk/files/extranet/docs/SSB/Maram%201.pdf (describing current effects of the commercialization processes on the treatment of tax-exempt organizations).

144. *Public Hearing*, *supra* note 108, at 37.

145. *Id.* at 38; *see also* Bello, *supra* note 103, at 622 (enumerating the activities that produce taxable income under the broader and stricter application of Business Tax). For more business activities not related to the educational purpose, see University of Florida Tax Services webpage at http://fa.ufl.edu/tax/unrelated-business-income-tax.asp (last updated Oct. 27, 2009).

146. Bello, *supra* note 103, at 622.

147. PUBLICATION, *supra* note 135, at 3.

148. *See, e.g.*, Steele v. Indus. Dev. Bd. of Metro. Gov. of Nashville, 301 F.3d 401, 403 (6th Cir. 2002), *cert. denied*, 537 U.S. 1188 (2003) (allowing the plaintiffs to bring lawsuit against a private school). The district court held that the plaintiffs had standing as "municipal taxpayers who have an interest in preventing their local government from subsidizing religious institutions." *Id.* at 403. The plaintiffs alleged that tax dollars were expended on behalf of a private religious institution in the form of the tax-exempt bonds. *Id.* They further argued that if the government did not issue tax-exempt bonds, the private school would finance the project through taxable funds, thereby enriching the city's treasury. *Id.* at 403-04; Bello, *supra* note 103, at 622.

149. There is a three-prong test used to determine whether income from a school's activity is subject to Business Tax. The elements are as follows: (1) it is income from a trade or business, (2) such trade or business is carried on by the institution (here, the school) on a regular basis, (3) and such trade or business is not substantially related to the institution's performance of its tax-exempt purposes. Treas. Reg. § 1.513-1(a) (2006). The need for "production of funds" does not make it substantially related to the school's performance of its tax-exempt purposes. *Id.*

if the university, under the terms of the agreement, performs little or no services, then it is not a business related activity and, thus, not taxable.[150] In the alternative, if the university engages in the "requisite amount of activity" to constitute trade or business, it will bear Business Tax.[151] Thus, the level of activity is the main factor.[152] Such apparent amorphousness and subjectivity create dangerous uncertainty.

When reading court cases discussing application of the Business Tax to schools' more and more commercialized activities, it is obvious that courts have a tendency to rule in favor of tax impositions.[153] Hence, it seems the law has created a delusional harbor. By allowing schools to believe they can be protected by their tax-exempt status—specifically, under the "substantially related to the performance . . . of its exempt purpose" shield[154]—the law drives schools to engage in business activities hoping for such protection. Unfortunately, the IRS surprises schools with its unexpected audits, unforeseen taxes, and costly litigation.[155]

B. Another Failed Rational for Tax Exemption: Supporting Science – Supporting Foreigners – Enslaving Freedom

Another reason given for validation of tax exemptions is that the federal government should not impose tax on qualified organizations that provide services that otherwise would be provided by the government.[156] This used to hold true in the sphere of academic research, where the federal government was the primary financier. These times, however, are long gone. Now, Congress itself has been promoting involvement of the private sector to fund academic research and build laboratories, so as to decrease its own financial involvement in this sphere.[157] This is most clearly evidenced by The Bayh-Dole Act.

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150. I.R.S. Memo, *supra* note 131 (setting up a framework for a basic analysis of the exclusive provider agreements in relationship to the Unrelated Business Income Tax).

151. *Id.*

152. *Id.*

153. *See generally* PUBLICATION, *supra* note 135 (examining the cases broadening the applicability of the Unrelated Business Tax, thereby ruling in favor of the exclusion of income from tax exemption); Bello, *supra* note 103 (surveying the cases that narrowed the exempt activities of schools).

154. PUBLICATION, *supra* note 135, at 3.

155. *See, e.g., IRS Taking on Entire Non-Profit 'Industries' in an Effort to Revoke the Tax-Exempt Status*, REUTERS, Mar. 13, 2008 (describing increasing audits of tax-exempt organizations by the IRS). During the interview with REUTERS, the IRS Commissioner said, "As to tax exempt institutions, I expect scrutiny of this sector to intensify, not diminish." *Id.*

156. STUDY, *supra* note 120, at 2. This makes sense as the federal government does not tax itself when providing services to the public. *Id.*

157. *See generally* discussion *supra* notes 36-46 and accompanying text (discussing private-sector involvement in academic research and its funding).

Unfortunately, this congressional practice comes at a high price. As detailed in Part II, commercial donors contribute substantial funds to academic research projects for the exclusive rights to inventions; quite often, these corporate donors are foreign businesses. Thus, the inventions and the rights to the inventions depart to exotic lands, even though the tag says "Made in the USA." In view of the above, the foreign corporate magnates enjoy, in part, the financially beneficial consequences of the tax-exempt status of universities. This leads to the conclusion that the individual taxpayers bear the burden for the benefit of the foreign industry. Just imagine: German pharmacology is supported by the taxpayers of Cook County, Illinois.

Additionally, universities have sacrificed their integrity for congressionally promoted industrial support.[158] The enslaved freedom is accompanied by excessive secrecy, financial conflicts, and, overall, undue control of the clinical research by the corporate stake-holders and financiers.[159] Today, sponsors "routinely exert control over the study design, the raw data, and even the way results get reported."[160] Nevertheless, government has its eyes wide shut because of financial convenience. It seems paradoxical: the government *ensures* that universities pay the Business Tax on the sale of a harmless teddy bear proudly bearing a school's logo;[161] but it chooses to ignore the "sold out to foreigners" academic clinical research in lieu of obtaining funds.

Thankfully, the current Obama administration has been advocating "comprehensive immigration reform that improves our visa programs to attract some of the world's most talented people to America."[162] This campaign was created with the goal of boosting the total patent application that would be awarded, in part, to U.S. universities.[163] In addition, the Obama administration claimed that the lack of such H-1B visas caused various entities to "push[] work to other countries."[164] This

158. BOK, *supra* note 5, at 77; *see also* WASHBURN, *supra* note 45, at 230-42 (claiming that universities voluntarily restrict their freedom when agreeing to be sponsored by the commercial sector).

159. BOK, *supra* note 5, at 77.

160. WASHBURN, *supra* note 45, at XV.

161. Almost all colleges and universities operate bookstores that sell items unrelated to the educational purposes, such as teddy bears, clothing, wall posters, and other memorabilia. I.R.S., ANNOUNCEMENT 94-112, EXEMPT ORGANIZATIONS: FINAL EXAMINATION GUIDELINES REGARDING COLLEGES AND UNIVERSITIES (Aug. 25, 1994). The sale of these items constitutes an unrelated business, which calls for the corporate-level tax. *Id.*

162. H-1B Visa Reform, National Association of Graduate-Professional Students 1 (2009) (emphasis added).

163. *Id.* (claiming that "skilled immigrants have a significant and positive impact" on future patent application).

164. *Id.* at 3.

proposal may be a half step forward to national invention protectionism; however, it does not defeat the evil of American enthusiasm and dependency on the foreign financiers.

Overall, the profitability pursuit transformed schools into lucrative enterprises that compromise traditional values and forsake original missions. Consequently, the original purposes for tax exemptions have become obsolete. Reflexively, the government has tried to adapt tax law to new realities by slowly, but continuously, restricting tax privileges. As a result, current exemptions law creates confusion in its application: it even has caused schools to assemble committees responsible solely for tax research, strategic tax planning, and tax analysis.[165] Yet, the federal government is reluctant to take more radical steps to heal degrading education and disoriented tax law.

IV. PROPOSAL

"The circumstances of the world are so variable that an irrevocable purpose or opinion is almost synonymous with a foolish one."[166]

As a response to the government's failure to cure the problem of outdated tax exemption law as applied to private universities, there are countless commentaries discussing it. Nonetheless, nothing seems to initiate a re-legislation of the issue. Additionally, even though scholars recognize the need for a change,[167] the approaches taken are more philosophical and theoretical.[168] Hence, this Comment puts forward a more tangible

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165. Inside Higher Ed, https://www.insidehighered.com (last visited Oct. 16, 2008) (listing vacancies for the tax specialists to ensure universities' compliance with federal income tax law).

166. This quote is attributed to William H. Seward (1801-1872), a United States Senator and Governor of New York, as well as the Secretary of State in the Cabinets of Presidents Abraham Lincoln and Andrew Johnson.

167. *See, e.g.*, Maram, *supra* note 143, at 3 (recognizing the existence of problems concerning Business Tax as well as adverse consequences of commercialization). Maram arrives at the conclusion that "reforms are needed to ensure that nonprofit organizations do not unfairly exploit their tax-exempt status." *Id.* Bello, *supra* note 103, at 627 (acknowledging that universities take advantage of their tax-exempt status and asserting that "if university funding continues to go unchecked, then MIT, for example, will soon stand for Microsoft Incorporated Trainees").

168. *See generally* Hansmann, *supra* note 106 (analyzing the underlying current policies for tax exemptions, surveying various theories to justify tax exemptions, and arriving at the conclusion how tax exemptions should be viewed); Colombo, *supra* note 109 (examining various justifications for the tax exemptions given to private universities as well as different theories, in conjunction with universities' evolution throughout history, and primarily focusing on the donative rational for tax exemptions); Lu, *supra* note 105, at 382-412, 423 (scrutinizing the Internal Revenue Regulations for vagueness

solution to cure the chronic illness of tax exemption law called "obsolete-ism," while evaluating current proposals.

A. Need for Brand-New Law: Present —Past —Future Triad

In 2007, the IRS released a redesigned Form 990,[169] a ten-page document with fifteen schedules and instructions.[170] By its design, the new form should "promote compliance by accurately reflecting the organization's operations so the IRS may efficiently assess the risk of noncompliance."[171] According to the IRS, this alteration was needed as there had been no change since 1979.[172] This remark poses a question whether this alteration is enough, as universities have transformed from donative organizations into commercialized concerns. It is unreasonable to expect necessary changes in the operation of law simply from a more detailed report to the enforcement authority. Indisputably, this is a necessary step to promote transparency,[173] but it is not sufficient to adapt the current tax law to the new socioeconomic realities.

That being said, let us reconsider the original purpose for the schools' tax-exempt status (the inability of universities to find capital) in conjunction with the original purpose of taxation (to tax

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with regard to tax exemptions of educational institutions and for their failure to provide guidance; emphasizing that "the purpose of [the] article is not to suggest that certain organizations should or should not receive tax exemption . . . [or] to argue that Congress should or should not . . . amend . . . the Code"); Cowan, *supra* note 63, at 509 (stressing that "the purpose of [the] [a]rticle is to . . . analyze the endowment issue in light of the literature on the optimal use of endowments"); *see generally* Andras Kosaras, *Federal Income and State Property Tax Exemptions of Commercialized Nonprofits: Should Profit-Seeking Art Museums Be Tax Exempt?*, 35 NEW ENG. L. REV. 115 (2000) (attempting to draw attention to the processes of commercialization and tax exemptions as a factor in this process but not confronting the issue of whether such commercialized nonprofits should maintain or lose their tax-exempt status).

169. On June 14, 2007, the Internal Revenue Service designed a plan to survey hundreds of universities in the summer of 2008 to oversee the distribution of their endowments. *A Broad Review of College Tax Compliance*, INSIDE HIGHER ED, Dec. 21, 2007, *available at* http://www.insidehighered.com/news/2007/12/21/irs. After the period of public comment, which accumulated over three thousand comments, the Internal Revenue Service issued an updated version of Form 990. This will be the return form that charities as well as tax-exempt organizations and foundations will file annually starting in 2009. IRS News Release IR-2007-204 (Dec. 20, 2007), *available at* http://www.irs.gov/newsroom/article/0,,id=176722,00.html [hereinafter Press Release] (*IRS Releases Final 2008 Form 990 for Tax-Exempt Organizations, Adjusts Filing Threshold to Provide Transition Relief*).

170. I.R.S. Fiscal Year 2008 Exempt Orgs. Guidelines, at 3, *available at* http://www.irs.gov/pub/irs-tege/fy08_implementing_guidelines.pdf.

171. *Id.*

172. *Id.*

173. *See* Testimony, *supra* note 109 (emphasizing the importance of transparency and fiscal accountability before the public in the financial management of donated funds).

the ability to pay and share wealth). It is absolute that modern-day schools have acquired the ability to pay by having access to millions, and even billions, of dollars of capital. Thus, the natural inference is that the federal government *should tax* private educational institutions, thereby stripping elite schools of this historically imposed, but now hollow, stigma of "needy" schools. Yes, the federal government imposes Business Tax on universities' unrelated business activities. From one perspective, *is this enough?* From another, *is this fair?*

As demonstrated above, the methodology for the imposition of Business Tax is unclear, confusing, progressively restrictive, and, most importantly, arbitrary.[174] It is a delusional safeguard for exemptions. Hence, universities conduct business capriciously, tying them to the educational purposes simply to get to the safe harbor. Furthermore, let us acknowledge that the Business Tax law was adopted in 1959; astounding progress has taken place since that time, and the process of commercialization of schools was the pioneer in this progress. Naturally, the Business Tax law is no more capable of handling the current trends. Thus, the ultimate question is: where will we be in twenty, fifty, one hundred years when the universitarian commercialization breaks new grounds and the untouched tax code remains in arrears?

B. The Brand-New Uniformed Law: Three-Step Calculation

For the reasons stated above, the current, obsolete law has to be changed with a "brand new" law. Accordingly, instead of attempting to find and rationalize the distinctions between the nontaxable education-related income and taxable business-related income, the government should make the taxation uniformed. Under the proposed "Uniformed Law," the first step should be the universities' report of the cumulative income figure of the entire endowment for the specified time period. This number should include private donations, corporate donations, investment income, income from all business-related activities, income from education-related activities, and all other income. This figure should exclude, however, federal grants so as to avoid circular financing.[175]

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174. IRS standards provide no clear guidance for courts or "for agency officials to efficiently and accurately determine when exemption is justified." Lu, *supra* note 105, at 382. Analogously, these standards provide no pattern for the educational institutions or other similarly situated organizations that would enable them "to properly structure their activities to qualify for exemption." *Id.*

175. If the cumulative figure of endowments reported to the IRS included federal grants, they would be taxed. In the event of such taxation, a certain percentage of the grant would be returned back to the federal government in the form of the collected tax. This process would repeat itself as the revenue of

The second step should be the calculation of the expenses for the university's maintenance: rent, upkeep, expansions, salaries, scholarships, classrooms, purchases of new technology, donations to museums, etc. This "university's maintenance" should be strictly interpreted so as to provide clarity and eradicate arbitrary judgments.

Third, the difference between the "cumulative income figure" and the "universities' maintenance figure" will be taxed. But the taxation percentage rate must be flat one-half of the average percentage imposed on corporations. This tax rate difference would distinguish wholly for-profit corporations and partially for-profit commercialized educational institutions. Additionally, the reduced tax percentage would encourage universities to allocate finances as needed without attempting to hide assets because each university will benefit from the profitable investments taxed at the lower rate they are being taxed presently; further, schools will not fear the full "corporate tax" in the event the IRS or a court finds no educational purpose tied to a certain commercial activity. Finally, in order to simplify the calculation of taxes and promote a clear taxable framework, schools should switch from the accrual basis of accounting to cash basis.[176] This change in the accounting method will create "one big checkbook" that will be easy to balance.[177]

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the federal government received from the taxation of federal grants constitutes a sum given to the educational institutions as a federal grant. Thus, this would produce circular financing.

176. Interview with Arthur Acevedo, Professor, The John Marshall Law School, in Chicago, Illinois. (Nov. 10, 2008) [hereinafter Interview]. Arthur Acevedo is an Assistant Professor at The John Marshall Law School. Professor Acevedo holds a Juris Doctor Degree, a M.S. in Taxation, a B.S. in Commerce as well as in Accounting and Finance, and he is a Certified Public Accountant. Professor Acevedo worked as an Internal Auditor for the Chicago Board of Education, as a Revenue Agent for the Internal Revenue Service, as a Tax Consultant for PriceWaterhouseCoopers, and as an International Tax Attorney for McDonald's Corporation. His academic background in taxation and extensive exposure to tax law in his career makes him an expert in the field of taxation. Furthermore, Professor Acevedo has a keen interest in the issues of taxation of endowments of elite schools.

177. *Id.* Specifically, under the cash basis accounting—also known as cash receipts and disbursements method—all items includable in gross income are reported on a tax return for the year when "actually or constructively received"; expenditures are deducted when actually made. Treas. Reg. § 1.446-1(c)(1)(i) (2006). Here, the *cash flow* is of the essence. Conversely, under the accrual method, income is included for the taxable year "when all the events have occurred that fix the right to receive the income and the amount of the income can be determined with reasonable accuracy." Treas. Reg. § 1.446-1(c)(1)(ii). Here, the *right to receive income* is of the essence. Thus, it seems the accrual method is more complex and amorphous than the cash basis method of accounting because it calls for reporting of income not yet physically received. This is especially true in the current market with financial uncertainties and instabilities.

Equally important, there should be a guarantee that universities will remain free to dispose of their resources as they deem appropriate, without a mandatory spending advocated by some policymakers.[178] Thus far, universities have allocated their resources efficiently, having an independent choice and opportunity to plan and structure future savings and expenditures. Otherwise, these schools would not be considered "elite schools"[179] and would not possess the largest endowments in the world, nor would they receive thousands of applications per year from high school students desiring to make these schools their alma mater.

C. Need for Public Transparency: Elimination of Oligarchy

Some commentators argue that if universities are taxed as private corporations, they will depart into a private sector, thus inhibiting public control and fiscal transparency.[180] But, as this

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178. Chuck Grassley, a member of the Senate Finance Committee, proposed a solution to the problem. Thomas Kaplan, *Senator Proposes Mandating Greater Use of Endowment*, YALE DAILY NEWS, Oct. 19, 2007, *available at* http://www.yaledailynews.com/articles/view/21942. The Senator's proposal would require universities with endowments exceeding $500 million to spend a mandatory minimum of 5% of their total endowments annually. *Id.* Senator Grassley substantiated his proposal with an argument that "[s]ome universities are sitting on endowments worth billions of dollars . . . . Why aren't the schools using that wealth to make college more affordable for families and students?" *Id.* Such legislation, for instance, would mandate Yale to increase its spending by approximately $280 million annually. *Id.*

Similarly, during a roundtable discussion of the leaders and researchers from the elite schools, which was organized to stimulate a dialog as to the tax-exempt endowments allocation, U.S. Representative Peter Walsh (District of Virginia) proposed imposing a mandatory 5% spending "to reduce the cost burden on students." *Watching Endowments, Not Legislating over Them*, INSIDE HIGHER ED, Sept. 9, 2008, *available at* http://www.insidehighered.com/news/2008/09/09/endowments [hereinafter *Watching Endowments*].

179. President of Yale Richard Levin commented on the above-proposed solution, stating that "we would much prefer to keep the matter one of private regulation rather than public regulation[.]" Kaplan, *supra* note 178. "We think that we've been very responsible in promoting access to the best possible education," he continued. *Id.*

Further, Yale Deputy Provost Charles Long advocated for an independent spending policy. *Id.* Mr. Long asserted that the annual spending depends on a complicated formula that takes into consideration the volatility of the market. *Id.* The representatives from Harvard, Yale, Brown, Princeton, and University of Pennsylvania also "aimed at correcting the 'incomplete and misleading account of the operation and uses of university endowments'" as well as "the impression that endowments are akin to automated teller machines from which universities can simply withdraw money at any point for any reason." *Id.*

180. *See, e.g.*, Kosaras, *supra* note 168, at 173 (arguing that exempt organizations remain transparent and accountable to the public as long as they have their tax-exempt status). Taxation of profitable not-for-profit organizations may discourage them from "thinking of their exempt activities

Comment proposes, universities would not be taxed as corporations, but rather would be taxed at a significantly lower rate. Moreover, regardless of the tax rate imposed, it is in the best interest of universities to keep the public informed of their activities as the public is one of the primary sources of income for universities.[181] Thus, public and individual donors would still exercise indirect control over the universities' activities despite the alleged discouragement of universities to report their management of taxable income.

Generally, under any regulation, the federal government should promote complete transparency of fiscal policies and behaviors of educational institutions. The reason being, lack of transparency leads to toxic oligarchy that promotes financial usurpation and erodes the foundation of trust and credibility. Thus, to promote credibility, schools should publish bi-annual statements of their income,[182] expenses, losses, income-expenses as to their business activities, and especially *compensations*.[183]

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in terms of tax-free profits." *Id.* Thus, this will result in the removal of the nonprofit organizations from the public scrutiny domain. *Id.*

181. *See supra* notes 66-69 (discussing donations from private individuals and entities). In January 2010, one Yale graduate donated almost $9 million to the Yale School of Management, "the largest gift to date from a young Yale University alumnus." *See, e.g., Yale SOM Announces Largest Alumni Gift to Date,* YALE UNIV. OFFICE OF PUB. AFF., Jan. 4, 2010, http://opa.yale.edu/news/article.aspx?id=7178.

182. It is common that lack of control over various sources of income leads to the undisclosed income; even universities themselves are not aware sometimes of the certain illegitimate dispositions of their funds. The following are examples of the lack of control and transparency that led to false reporting. For instance, a Harvard professor accepted $150,000 grant from the Central Intelligence Agency without informing the University. Christopher J. Georges & Michael W. Hirschorn, *Prof Took 2nd CIA Grant*, THE HARV. CRIMSON, Oct. 11, 1985, *available at* http://www.thecrimson.com/article.aspx?ref=271595. The grant was used to support his research and writing of the book "Saudi Arabia, The Ceaseless Quest for Security." *Id.* The accused professor admitted, "There is no attempt to cheat the University out of money, but it is a convenient way of getting funding for the center with no strings attached." *Id.*

In its turn, Yale had used money from one grant to finance a different research project; consequently, the University had to alter certain documentation in connection with the transference of the funds, thus misreporting the allocation of the grants. Alan Finder, *U.S. Begins Inquiry into the Handling of Research Grants at Yale*, N.Y. TIMES, July 4, 2006, at B2. As a result of this scandal, Yale promised to improve its reporting and accounting procedures. *Id.*

Moreover, the following has become a matter of common practice: the leading researchers on universities' campuses receive payments from pharmaceutical companies (or other organizations-financiers) without reporting them to the appropriate authorities. Gardner Harris & Benedict Carey, *Researchers Fail to Reveal Full Drug Pay*, N.Y. TIMES, June 8, 2008, at A1.

183. It is a never-ending concern as to presidential pay. In 2008, the mass media focused on the significant increase in the salaries of university

In an interview of Arthur Acevedo,[184] an Assistant Professor of Law at the John Marshall Law School, conducted on November 10, 2008, he most vigorously advocated the detailed disclosure of the top twelve individuals of elite schools. His reasoning was based on the fact that those individuals have the most control in schools' management, they are empowered by the decision-making authority, and, naturally, they have the highest compensations.[185] Indeed, they serve as a clear representation of a top marginal point of the current compensation levels of "high executives" at schools with sizeable budgets as well as of their influences on the internal policies as to compensations.[186] Further, Professor Acevedo called for a public disclosure of the related-party agreements entered into by the faculty members.[187] Certainly, this would expose the possible conflicts of interests, the impact on the performance of the faculty members at schools, and the possible limitations/restrictions as to the performance of duties by the faculty members inadvertently (or advertantly) imposed by said agreements. Overall, these statements must be detailed and comprehensible, so the public has easy access and knowledge as to how its direct donations (and indirect payments through taxes) are managed.

Unequivocally, public control of fiscal responsibility cannot be overstated. This is acknowledged by the courts' recognition of citizens' standing to sue tax-exempt educational institutions.[188] Moreover, when there is no substantial public accountability, there is "enormous room for abuse."[189] The need for accountability has been expressed repeatedly in the past as well. Economist Eric A. Hanushek once wrote that everybody perceived and treated schools like a mission to the moon: "that if we just put in enough resources, we could solve everything."[190] Sadly, Hanushek

presidents. *Senators Scrutinize Well-Endowed Colleges*, INSIDE HIGHER ED., Jan. 25, 2008, *available at* http://www.insidehighered.com/news/ 2008/01/25/ senators [hereinafter *Senators*].

184. Interview, *supra* note 176.

185. *Id.*

186. *Id.*

187. *Id.*

188. *See Steele*, 301 F.3d at 303.

189. Testimony, *supra* note 109. When there is a "true public accountability and public control over assets," then one can be certain that the individuals in control of the endowments or any other funds "will be careful about their mission and the execution of that mission, because a publicized misstep will have significant adverse affects on the public funding of that organization." *Id. See also* Bello, *supra* note 103, at 622 (asserting that the "court-sanctioned empowerment of taxpayers" to bring legal actions against educational institutions regarding their tax exemptions will result in "careful scrutiny of these exempt institutions").

190. Bill Evers, *Influence of Economists in Education?*, ED. POLICY, Aug. 27, 2009, http://ed-policy.blogspot.com/2009/08/influence-of-economists-ineducatio

admitted, "we found that money wasn't the only solution. And that led to lots of questions. One of the aspects of doing better was to have *better accountability*."[191]

Unfortunately, Form 990 by itself does not ensure financial transparency that is evidenced by scholarship advocating the amendment of the Form that would reveal the endowment management practices.[192] Thus, internalizing the lessons of the past with the view of promoting transparency in the future, the IRS should mandate schools to submit the above proposed bi-annual universities' financial statements, which would be available on-line without subscription fees to the public.[193] Of course, schools' resistance to such reporting is expected; they might claim that such reporting requirement will be burdensome and costly. In fact, similar arguments were made by schools when the IRS amended its Form 990.[194] But these arguments are easy to counter: the cost of preparing these additional financial statements would be minimal as practically all schools already maintain an accounting staff to comply with other tax regulations (e.g., Form 990). Furthermore, there would be no distribution or publication cost as the financial report would be released on-line.[195]

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n.html (citing to economist Eric A. Hanushek).

191. *Id.*

192. *See, e.g.*, Waldech, *supra* note 86, 1816-17.

193. NACUBO compiles the detailed information as to the universities' management of their endowments. In fact, the redesigned Form 990 employed a significant number of questions used in the survey of NACUBO. The website address is http://www.nacubo.org. But the website access to the reports is closed without subscription. In the alternative, one may order a financial report of the surveys prepared by NACUBO; unfortunately, the Endowment Study Report cost $335.00 at the end of 2008—talk about indirect hindrance to the transparency and public control. Furthermore, as some state, NACUBO presents the investment information and statistical data it compiles "in ways that often shield the identity of particular schools." Waldeck, *supra* note 86, at 1816-17. *See Senators*, *supra* note 183 (discussing the importance of the NACUBO Endowments Study and Survey).

194. "For most colleges and universities . . . the new reporting regime will be more complex and burdensome than before." NAUBO, *Redesigned Form 990 Released by IRS,* Jan. 2, 2008, http://www.nacubo.org (follow the links "Business & Policy Areas," "Tax," "News," "2008," and find the article's name).

195. Interview, *supra* note 176. Additionally, as other scholars noted, "[u]niversities may not like the increased scrutiny, but they have little grounds on which to object. . . . such expenditures are unlikely to be a significant factor in a university budget." Waldeck, *supra* note 86, at 1816-17 (discussing the reaction of schools to the proposed amendment of Form 990 itself that would reveal the endowment management practices).

V. CONCLUSION

In summary, once undercapitalized higher education has undergone a dramatic transformation into lavishly lucrative enterprises. The tax code, with its obsolete vision, has failed to adjust to this transformation. The government's attempts to adapt proved insufficient. Thus, this Comment proposes a "uniformed taxation," where the difference between the "cumulative revenue figure" and the strictly construed "university's maintenance expenses" is taxed at the rate one-half of those currently imposed on the unrelated business income and on actual corporations.

Reflecting on the above, one may argue that we cannot impose a blanket tax (regardless of education-related activities) on schools because they are too important. I would respond that they indeed are; however, no matter how important something may be, it should not abuse its privileges. Otherwise, the Scale of Themis will be tipped toward disbalance, inequity, and injustice. In the end, universities will benefit by not paying Business Tax at the rate paid by wholly for-profit corporations, the federal government will increase its revenue, and the citizenry will not carry the entire burden of universities' tax-exempt status.

"Ask me three main priorities for Government, and I tell you: education, education, education."[196]

196. Prime Minister Tony Blair, Speech at the Labour Party Conference (Oct. 1, 1996).