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TRENDS IN CORPORATE CHARITABLE CONTRIBUTIONS

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I. INTRODUCTION

This paper presents preliminary results of a study of trends in corporate charitable contributions using the Internal Revenue Service's Corporate Tax Files.[1] This work may be taken as an extension of earlier studies by Hayden W. Smith[2] and Thomas W. Vasquez.[3]

At the risk of revealing too much too soon, this study finds that contributions can be expected to continue to increase as the economy expands and corporate profits grow. However, the underlying structure of industry that supports corporate charitable contribution growth has been, and is, changing. As we look ahead, this underlying structure appears unlikely to sustain charitable contribution growth at rates comparable to those of the past.

A. *Characteristics of the IRS Data*

Among other deductions they may declare on their federal income tax returns, corporations can include, as a discrete item, the total amount of their allowable charitable contributions.[4] Since other articles from this Symposium[5] address the Internal Revenue Code in depth, its specifics will not be discussed here. We simply note that only gifts to certain types of organizations qualify as charitable contributions, the maximum amount

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1. The IRS Corporate Tax File is in the possession of the author. All future references, unless otherwise cited, are to this file.

2. *See* HAYDEN W. SMITH, COUNCIL FOR AID TO EDUCATION, A PROFILE OF CORPORATE CONTRIBUTIONS (1983).

3. *See* COMMISSION ON PRIVATE PHILANTHROPY AND PUBLIC NEEDS, U.S. DEP'T OF THE TREASURY, CORPORATE GIVING MEASURES 1839-52 (1977).

4. *See* I.R.C. § 170 (1994).

5. *See, e.g.*, Francis R. Hill, *Corporate Philanthropy and Campaign Finance: Exempt Organizations as Conduits for Corporate Political Contributions*, 41 N.Y.L. SCH. L. REV. 881 (1997); Nancy Knauer, *Reinventing Government: The Promise of Institutional Choice and the Government Created Charitable Organization*, 41 N.Y.L. SCH. L. REV. 945 (1997); Daniel Shaviro, *Assessing the "Contract Failure" Explanation for Nonprofit Organizations and Their Tax Exempt Status*, 41 N.Y.L. SCH. L. REV. 1001 (1997); Linda Sugin, *Theories of the Corporation and the Tax Treatment of Corporate Philanthropy*, 41 N.Y.L. SCH. L. REV. 835 (1997).

allowed in any one year is currently ten percent of taxable income,[6] with some carry forward allowed up to five years,[7] and certain gifts of product and property are subject to enhanced tax treatment.[8]

Limitations in the IRS data on corporate contributions are of two main types: conceptual and timing-related. Conceptual limitations include the obvious fact that the data reflect only what corporations report on their tax returns. Contributions made, but not declared, are simply missed. Additionally, the data include contributions by corporations to their own foundations and exclude grants by corporate foundations to other nonprofit organizations. To the extent that these two flows do not match each other in any given year, the IRS data will be misleading in terms of the actual flow of contributions from the corporate community (corporations and their foundations combined) to the nonprofit community. Timing-related limitations concern various ways that the reported contribution amount in a given year may actually reflect some contributions made in another year, thereby distorting the IRS-reported amounts in both years. For instance, contributions made by a corporation in a year of low profits that exceed the ten percent of taxable income ceiling, and thus cannot be taken as a charitable deduction, may be taken up to five years later.[9]

However, these limitations are not significant enough to affect any of the findings discussed below. And while these and other limitations are real, the IRS data have the great strength of reflecting essentially all corporations. Problems and uncertainties that may arise from estimates based on small or unrepresentative samples are not an issue. An excellent discussion of limitations in both the IRS data and alternative measures of corporate charitable contributions may be found in the appendices to Hayden W. Smith's study.[10]

B. *The Question of Non-Charitable Forms of Support*

In the discussion so far, the operative term has been "charitable." There remains the vexing question of the extent to which the IRS data provide an adequate picture of corporate support of nonprofits taken in a broader sense. This broader sense is one that includes, but is not limited to, charitable (tax-deductible) contributions. It could also include such

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6. *See* I.R.C. § 170(b)(2) (stating that the total deductions a corporation can make may not exceed 10% of the corporation's taxable income).

7. *See id.* § 170(d)(2) (allowing contributions made by corporations in a taxable year in excess of the amount deductible for that year to be deductible for five successive years).

8. *See id.* § 170(e)(3).

9. *See id.* § 170(d)(2).

10. *See* SMITH, *supra* note 2.

corporate transactions as, for example, contract research, joint-ventures, and cause-related marketing. These are not charitable contributions, but they may achieve much the same effect for both the corporation and the nonprofit. From both the corporate and the nonprofit perspective, any interest in trends will ultimately encompass this broader sense of support. Unfortunately, systematic data are not currently available that allow us to explore trends in a broader measure of support that includes these non-charitable amounts. While this paper primarily explores trends in corporate *charitable* contributions, it will address the subject of a broader concept of corporate support of the nonprofit sector in the conclusion.

II. TRENDS IN CORPORATE CHARITABLE CONTRIBUTIONS

Detailed corporate contribution data are available from the IRS in electronic form. These data are aggregated across corporations within industry groups by various asset size for all corporations combined and for only corporations showing positive net income in a given year. Data become available three years after the fact. Therefore, this study largely covers the years from 1980 through 1993. In some places we have made estimates for 1994 and 1995 and in several places we have used non-electronic sources to track trends as far back as 1936. In addition to the contribution amount, other variables in the IRS electronic files include number of returns, assets, liabilities, receipts (income), deductions in detail, various net income measures, and taxes paid.

A. *The Long View*

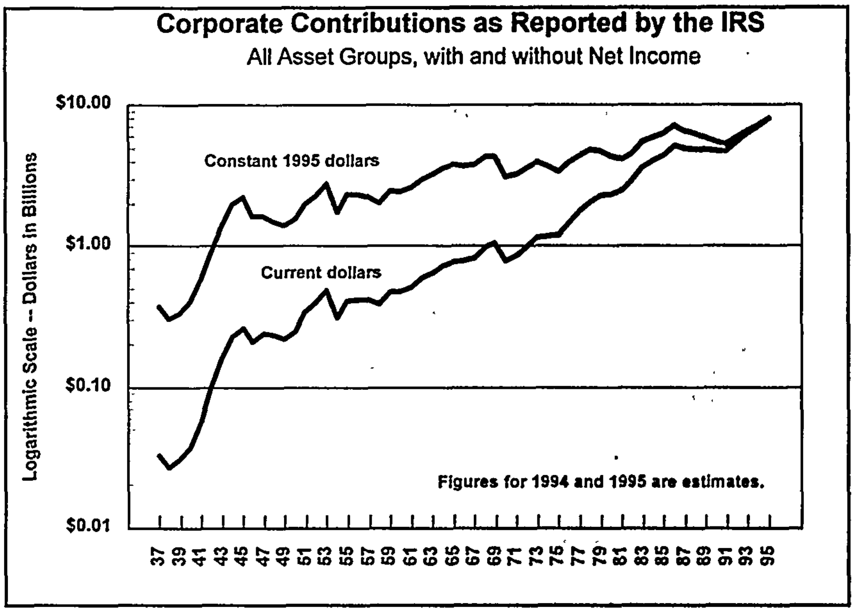

Figure 1

Figure 1 shows current and constant dollar amounts of corporate contributions as reported by the IRS from 1937 through 1993 (1994 and 1995 are estimates based on corporate pretax net income as reported in the Commerce Department's National Income and Product Account Tables). The scale is logarithmic so that comparable percentage changes have the same visual weight. Thus, a $100 million rise over a prior year's figure of $1 billion stretches the same length as a $500 million rise over a prior year's figure of $5 billion.

In constant dollars, contributions climbed from $400 million in 1937 to an estimated eight billion in 1995. It is clear that contributions grew rapidly after 1936, when the charitable contribution deduction was first introduced, through the end of World War II. Since then, taking the long view, there has been rather steady upward movement, albeit with dips and rises along the way.

B. *Relation to Gross Domestic Product*

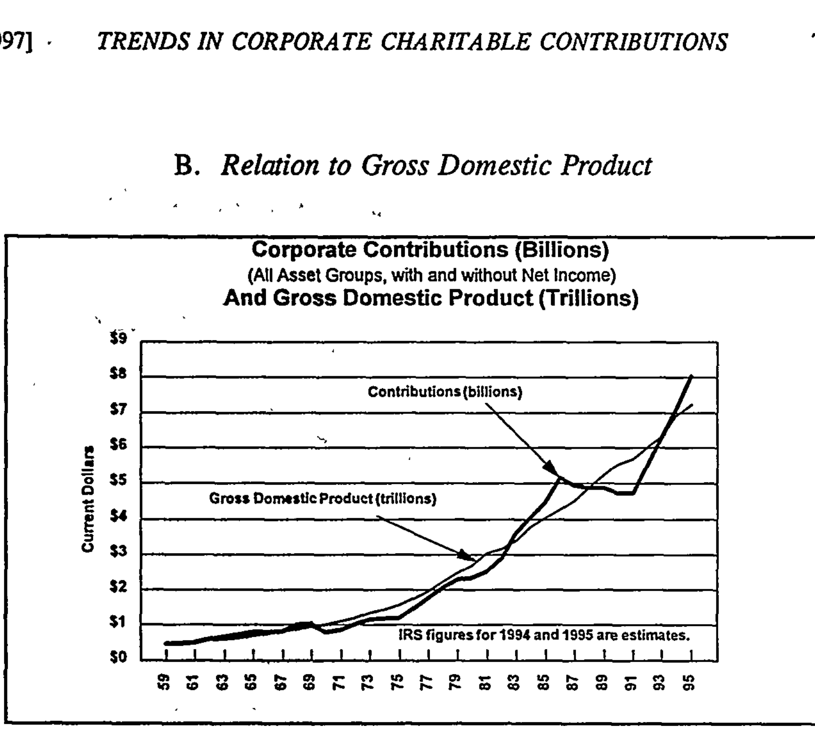

Figure 2

Of course, over this long period of time, most economic indicators will show dramatic growth, and corporate contributions have simply kept pace. Figure 2 displays growth in contributions in relation to growth in the overall economy as measured by Gross Domestic Product (GDP).[11] Note that while corporate contributions are shown in *billions* of dollars, GDP is shown in *trillions* of dollars. As a simple rule of thumb, then, corporate contributions tend to represent about one-tenth of one percent of GDP and Figure 2 makes clear that contributions have grown apace with the overall economy. At no point is there compelling evidence of a dramatic shift in the level of charitable support of nonprofit causes, as reflected in the IRS data. This is not the same as saying that there has been no increase in the corporate "commitment" to the nonprofit sector. There may be, but it is not captured by the IRS data and is probably not charitable in the tax-related sense. Nor is this to say that nothing unusual happened between 1983 and 1992. Unusual events occurred and we will look at them more closely below.

11. Gross Domestic Product data is available from 1959.

C. *Relation to Corporate Profits*

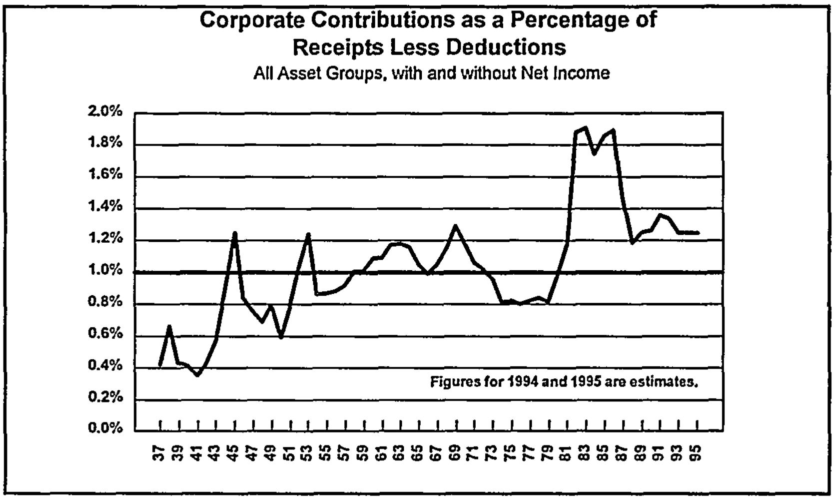

Figure 3

It is also useful and customary to view corporate contributions in relation to a measure of corporate profits. In theory, this view allows us to see shifts in the level of corporate "commitment" to nonprofits as reflected in their decision to divert a larger share of profits to charitable causes. Figure 3 utilizes an IRS measure of corporate profits (Total Receipts Less Total Deductions or RLD) to create a contribution ratio that helps demonstrate whether contributions have kept pace with profits. Many corporations explicitly set their level of giving in relation to their profitability.

Subsequent to the early increase in contributions, which was related to its initial allowance as a deduction by the IRS and the corporate response to extraordinary social and humanitarian needs during World War II (through 1945), contributions hovered around 1% of profits (+/- 0.2 percentage points) through 1981. Peaks reached in the early 1950s and again in the late 1960s correlate to the Korean and Vietnam wars. Another reason for these war-related peaks was that during these periods, excess profit taxes had the effect of lowering the after-tax cost of the contributions.[12]

D. *The Unusual Period Between 1982 and 1991*

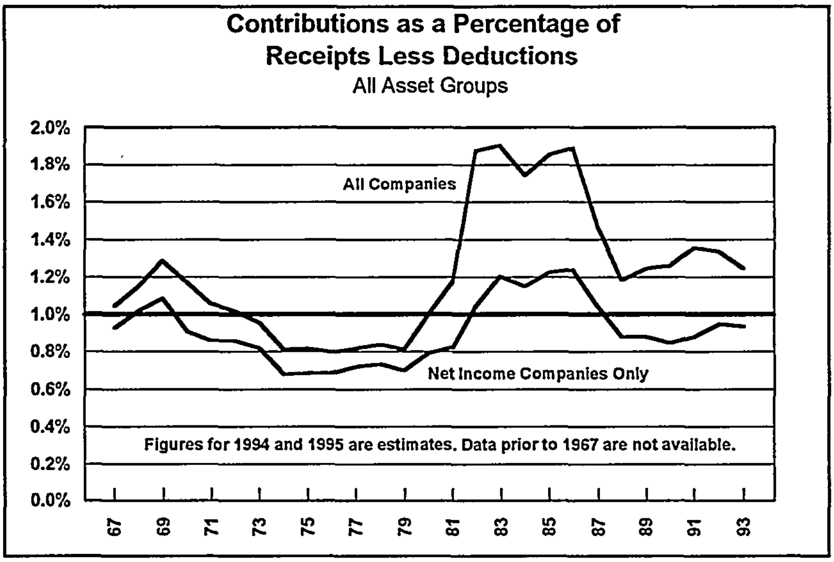

Figure 4

Obviously, though, between 1982 and 1991, something out of the ordinary happened. Several events occurred that make this period especially useful to demonstrate the interplay of economic and tax factors on corporate charitable contributions. First, during this period there was dramatic growth in the size of the aggregate deficit reported by all corporations operating at a loss. The extent of this can be seen in Figure 4, where the contribution ratio is shown separately for all corporations combined and also for those corporations with positive net income.

These positive net income companies have a higher total RLD figure (there is no negative income dragging their total RLD down) as their ratio's denominator, and this has the effect of lowering the ratio. However, because corporations cannot take a charitable deduction in years

12. *See* CHARLES T. CLOTFELTER, FEDERAL TAX POLICY AND CHARITABLE GIVING 199-200 (1985) (explaining that corporations made larger contributions during these years to offset taxes on higher earnings).

when they have no net income,[13] the contribution amount (the ratio's numerator) is the same for both groups of corporations. For all corporations combined, the ratio approaches the unprecedented level of 2% of RLD, while for the profitable corporations alone it also increases, but remains within the upward bound of historical levels (1.2%).

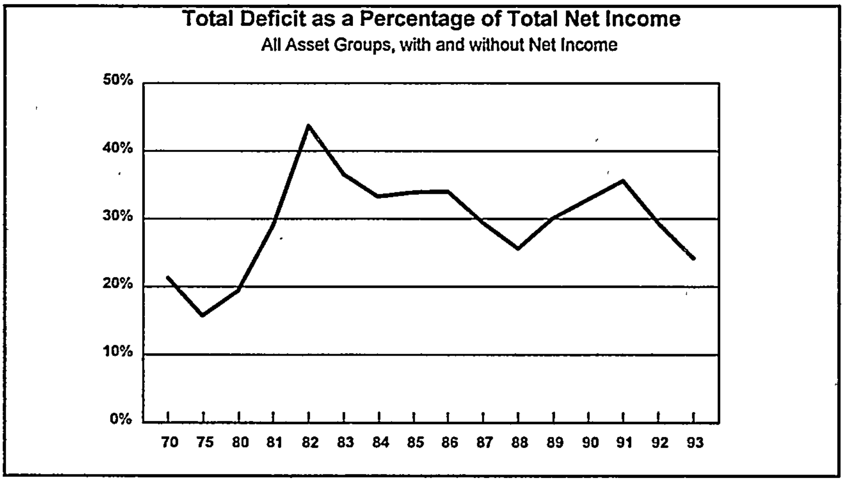

Figure 5

Figure 5 shows the actual extent of the deficit increase during this period, with the total deficit of corporations operating at a loss presented as a percentage of the RLD of corporations operating profitably. From a level of around 20% through 1980, the ratio jumps to 30% in 1981 and to 44% in 1982. Only recently has it shown signs of moving back toward a level around 20%, but it will take several more years of data before we can confirm this downward trend. The effect of this amount of deficit was to pull down sharply the *overall* RLD level (the total RLD of profitable corporations minus the deficit amount of the corporations operating at a loss) and raise the contribution ratio, particularly during the early 1980s. The increase in the deficit was partly due to a downturn in the economy, but there may also have been a shift in corporate thinking that made deficits more acceptable at this time. Additional research is needed to better understand the causes behind the dramatic rise in the deficit amount.

13. *See* Hayden W. Smith, *If Not Corporate Philanthropy, Then What?*, 41 N.Y.L. SCH. L. REV. 757, 766-67 (1997) (stating that corporations claiming a net loss cannot legally claim any deductions for charitable giving).

Contributions grew during this period when the economy started expanding again, but not at a similar rate that the increase in the ratio for all corporations combined suggests. In addition, changes in the Tax Code appear to have had a positive effect. The 1981 Economic Recovery Tax Act, effective in 1982, raised the limit on corporate charitable deductions from 5% to 10% of pretax net income.[14] The Act also enhanced the valuation of company products to encourage equipment gifts for scientific research.[15]

Also during this period, corporations were responding appropriately to anticipated changes in the Tax Code that were scheduled to take effect in 1987 (Tax Reform Act of 1986).[16] From the IRS data and from surveys of corporations on their charitable giving activity at that time, it is evident that corporations "prepaid" or otherwise accelerated contributions in order to take advantage of the more favorable tax treatment that would be lost after 1986. The planned drop in the marginal tax rate for corporations from 46% to 34% would, in its after-tax effect, make contributions more expensive. One stratagem of corporations during this period was to increase contributions to their own foundations. These funds could then be disbursed to nonprofits at a later time. The steep rise in contributions for several years prior to 1987, and the steep decline for several years after, reflects in large part such "prepayment" activity.

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14. *See* I.R.C. § 170(b)(2) (1994).

15. *See id.* § 170(e)(3)(B) (allowing a taxpayer to deduct an amount equal to the taxpayer's adjusted basis or cost plus one-half of the unrealized appreciation, provided such amount does not exceed twice the taxpayer's basis).

16. *See id.* §§ 11(b), 1201(a) (stating that the maximum tax rates imposed on a corporation's taxable income is 34%).

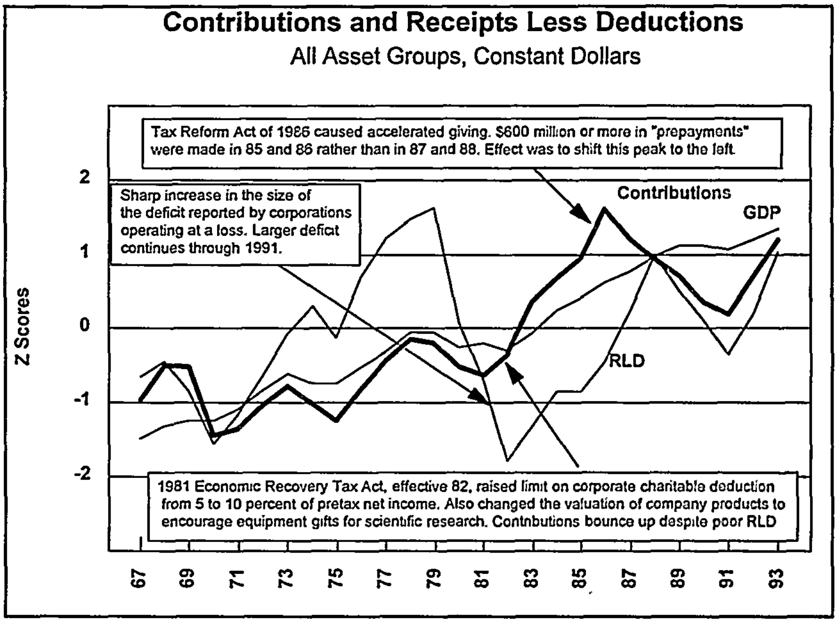

Figure 6

With some careful scrutiny, Figure 6 can help one isolate the effects of these different events and show their cumulative effects. The data for contributions, RLD, and GDP have been transformed to standard (Z) scores to align the data on a common scale. By and large, the three lines stay in synchronization. Where they do not, there are straightforward explanations as noted above and in the figure. Both RLD and contributions are sensitive to relatively small shifts in the economy as represented by GDP. RLD fluctuates more dramatically than contributions because corporations have an interest in, and mechanisms for (their own foundations especially), buffering their contribution programs from profit volatility.

E. *Corporations With Assets of $250 Million or More*

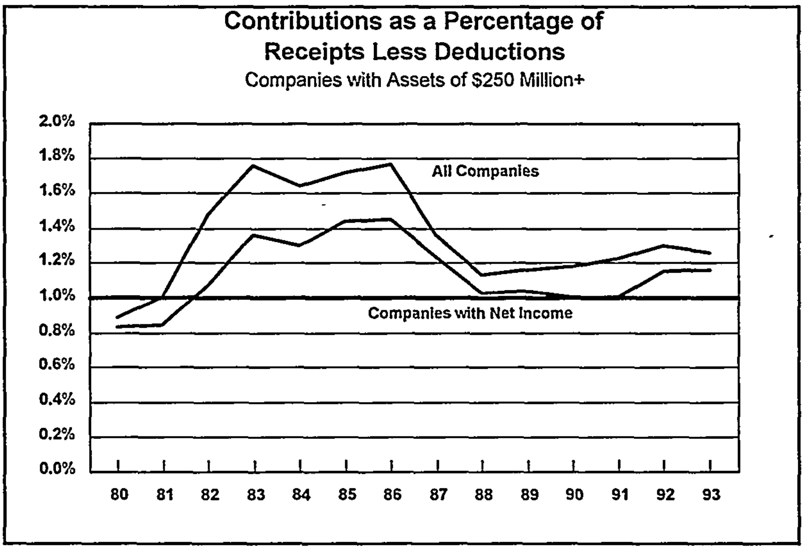

Figure 7

So far the focus has been on all corporations, regardless of their size. Figure 7 is similar to Figure 4 except that it shows contributions of just those corporations with assets of $250 million or more. Within the IRS data set this is the subgroup of largest corporations. In 1993, these 6798 corporations accounted for less than .2 of 1% of the 4 million corporate tax returns filed, but they account for 82.7% of total assets, 78.4% of total contributions, and 77.6% of total RLD. With these large corporations we are closer to focusing on the relatively small number of huge corporations that drive the contribution numbers. Figure 7 differs from Figure 4 in that the line for all corporations shifts down slightly (the larger corporations account for a disproportionately smaller share of the deficit total), while the line for net income-only corporations rises slightly (the larger net income companies account for a disproportionately greater share of contributions). Bear in mind also that the same contribution amount is in the numerator of the ratios for both groups of corporations displayed in Figure 7. It is differences in the denominators, RLD, which causes the ratios to differ.

F. *Differences Across Industry Sectors*

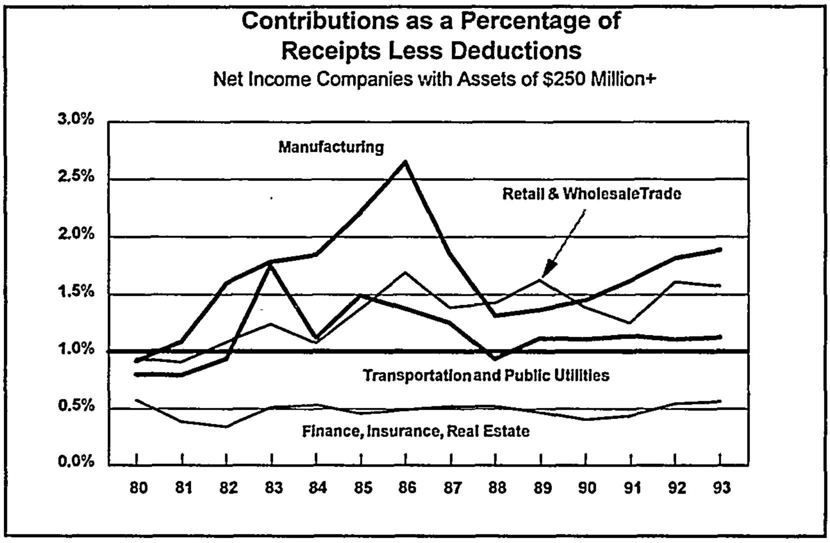

Figure 8

Within this group of largest corporations, we can look at industry sectors and see the more detailed structure that underlies the aggregate numbers. Figure 8 shows the Figure 7 data disaggregated by four major industry sectors: Manufacturing; Finance, Insurance, Real Estate; Transportation-Public Utilities; and Retail-Wholesale Trade. These four sectors consistently account for over 95% of the contributions reported by all corporations with assets of $250 million or more, and 75% of total contributions reported by all corporations combined. These different sectors give at very different rates. Clearly, the Manufacturing sector has been giving at a rate well above the rest. This can be explained in part, by the option they have to make product gifts with their preferential and attractive tax treatment.[17] It is also generally thought that this sector has the strongest and longest tradition of giving, particularly in their support of higher education,[18] where they have a particular stake. Manufacturing accounts for much of the increase in the contributions to RLD ratio in the

17. *See id.* § 170(e)(3).

18. *See* CLOTFELTER, *supra* note 12, at 180-81 (stating that education receives the largest shares of charitable contributions from the manufacturing sector).

early 1980s. This sector was able to take advantage of the enhanced tax treatment for product gifts afforded by the Tax Reform Act of 1981.[19] Also, more than the other sectors, Manufacturing appears to have prepaid or otherwise accelerated its giving in anticipation of the Tax Reform Act of 1986.

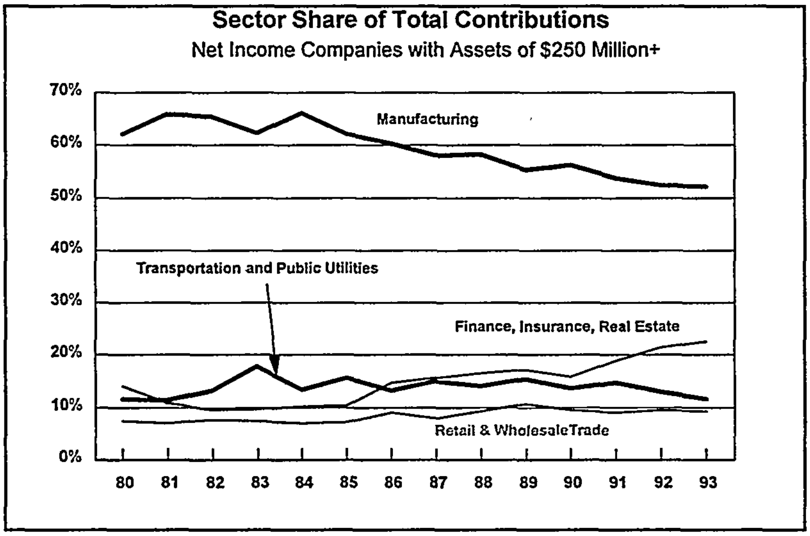

Figure 9

Figure 9 shows the share of all contributions reported by each of these four sectors. In spite of its relatively high contribution ratio over the years covered, Manufacturing's share of total contributions has been falling, from 62% in 1980 to 52% in 1993.

19. *See* I.R.C. § 170(e)(3)(B) (1994).

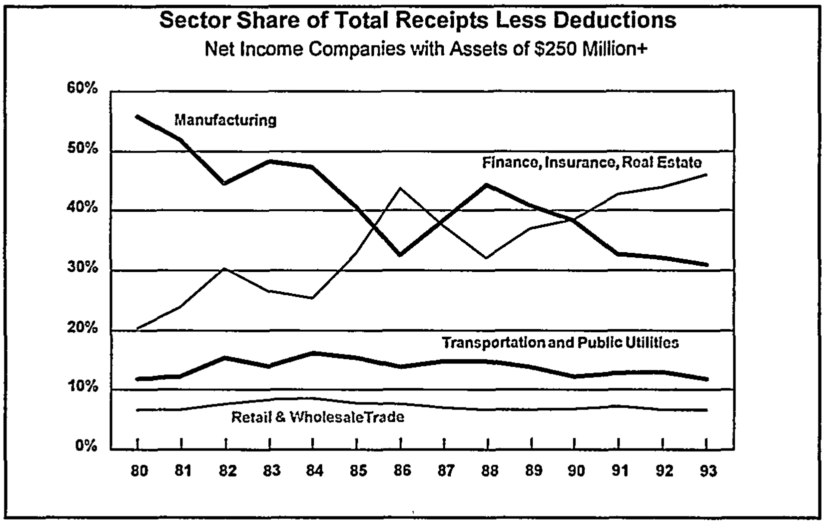

Figure 10

Figure 10 shows the share of RLD attributable to each of these four sectors. The frequently cited shift in the U.S. economy from manufacturing to services, especially finance-related,[20] is starkly apparent. Manufacturing's share of RLD fell from 56% to 31% between 1980 and 1993 alone. During this same period, the share of RLD represented by Finance-Insurance-Real Estate climbed from 21% to 46%. This sector, responsible for so much of the economic growth and profit during this period, has on average, a contribution ratio of about one-third that of the Manufacturing Sector. However, we should not be quick to draw any particular conclusions from this sizable difference. More needs to be understood about possible differences in the RDL amounts across sectors. For instance, the finance and insurance subcategories include mutual companies, and we do not yet know about any exigencies that may affect this sector's capacity to make contributions, or that may make its RLD figures not comparable to other sectors. Nevertheless, this shift in relative share of RLD from Manufacturing to Finance-Insurance-Real Estate would appear to be bad news for those organizations dependent on corporate charitable contributions.

20. *See* Barbara Reisman, *The Economics of Child Care: Its Importance in Federal Legislation,* 26 HARV. J. ON LEGIS. 473, 477 (1989) (stating that the economic base of the United States has shifted from manufacturing to services).

Finally, we also need to consider that these are all aggregate figures. Within any of these sectors there will be a wide range of contribution practices and ratios across specific corporations. For instance, there are banks that give well above the 0.5% level and manufacturing companies give well below 1%.

III. WHAT DOES THE FUTURE HOLD?

What do these differences in contribution ratios and shares of RLD mean for the future of corporate contributions? What will happen to total corporate contributions if Manufacturing's share of RLD (and RLD is the font from which corporate contributions flow) continues to shrink while Finance-Insurance-Real Estate continues to grow? Even if no single company changes its own giving practices, the effect will be significantly negative over the longer term. The changing structure of U.S. industry alone will reduce contribution growth from what it would have been had the Manufacturing sector held "profit share" or Finance-Insurance-Real Estate increased its contribution ratio. Let us look at some very simple projections for these four sectors within the $250 million or more asset group in order to see how the dynamics of contribution ratios and RLD shares play out.

For purposes of this exercise, we ignore inflation and assume average annual growth of RLD at 7% (it grew an average of 12% annually between 1980 and 1993). We also assume a continuing, but slower, shift of RLD share from Manufacturing to Finance-Insurance-Real Estate (with the former moving down to 26%, and the latter climbing to 51%, by 2010), and no change in contribution ratios from 1993 levels. Under this scenario, contributions from this critically important subset of all corporations will grow from their reported $4.7 billion in 1993 to a projected $12.4 billion in 2010. While impressive, this amount will be $800 million less than the $13.2 billion that could be expected were the sectors to hold their shares of RLD at 1993 levels. If, however, Finance-Insurance-Real Estate were also to raise its contribution ratio from 0.5% to 1%, which would still be the lowest ratio of the four sectors, expected contributions would climb to $16.5 billion by 2010, or an additional $3.3 billion. One can conclude that unless Finance-Insurance-Real Estate increases its contribution ratio, it is unlikely we will see corporate charitable contributions climb in the future at a pace consistent with the past. Ratios of corporate charitable contributions to profits in the future are likely to appear to indicate that corporate America has decreased its support of nonprofits. This can happen even though no single corporation will have cut back its contribution ratio.

IV. CONCLUSION

Trends in corporate support of nonprofits have been explored to this point solely as they are reflected in the IRS data. We have only looked at corporate support of nonprofits that meets IRS charitable deduction criteria. A fundamental question that can be asked is to what extent have corporations found other ways to support nonprofits, ways that are beneficial to both parties, but that are not charitable in the strict (IRS) sense of the word?

We can look at these issues from the corporation's point of view using a rational economic model. Charitable contributions are an economic transaction made in expectation of some future corporate benefit, however intangible. The expectation of a corporate benefit from a charitable contribution is real, but it typically is very difficult to determine later the degree to which the expected benefit was realized. This is in the nature of most, if not all, charitable contributions. One can even postulate that to the extent a transaction under consideration can submit to a rigorous cost/benefit analysis in advance and later have its expected benefit actually measured, the greater the likelihood will be that the transaction under consideration will not be structured as a charitable contribution. Instead, it will be structured as a more routine corporate purchase by marketing, research and development, or some other appropriate unit within the corporation. By situating it in one of these units, the expenditure can fit within formal planning, decision-making, and accountability processes. Of course, corporate decision-making about contribution programs is also situated within this formal planning process. But how effectively can it compete for resources when its expenditures under consideration are those that, by their very definition, hold the least precise and measurable promise of a specific corporate benefit? A contribution budget or specific contribution that is weighed and then approved will carry some kind of promise of a benefit (if none can be articulated at all, we can be confident it will not be approved). But it appears that the value attached to these indistinct benefits total, in the aggregate, only about 1% of profits or one-tenth of 1% of all expenditures (all tax deductions). At that level, it is, if nothing else, a very safe and inexpensive outlay. It is basically an insurance policy against unhappy consequences that might result were no charitable contribution made at all.

This is not a rap against corporate giving practices or levels. Rather, it is simply recognition of a consequence of the rational economic model that underlies corporate decision-making in a competitive, market-driven economy. This same model may serve, and may have already served, to boost non-charitable corporate support of nonprofits—at least to those that can offer a clear and compelling benefit to corporations. Anecdotal information suggests that this has been happening. It deserves fuller attention, both to determine its extent and to determine its effect on the missions and activities of nonprofits.