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Before launching into our discussion regarding the charitable deduction, I cannot resist wondering whether the failure to have Carnegies and Mellons today is more a function of the presence of the income tax rather than the inadequacy of the corporate deduction for charitable giving, however, I do not have an answer to that right now.

It is interesting, historically, with the federal government de-funding many programs, we have come almost full circle. From the point of view of the individual tax-exempt organization, whether it is a homeless shelter, a substance-abuse facility, or a cultural organization, it is going to be looking more and more to the corporate donor—the corporate philanthropist, if you will—to provide the funds to fuel those thousand points of light.[1] That brings us back to the situation that existed in 1935,[2] when the corporate charitable deduction was first established.[3] That is all I am going to say about policy because my perspective is primarily that of a practicing lawyer who represents all types and sizes of nonprofit organizations, and if I talked to them about their concerns regarding corporate philanthropy, they would not begin asking policy questions. They would ask how to get more corporate donations, how to keep getting them, and how to use them to leverage their other donations through matching programs and good publicity.

I am here to talk 'Tax 101' regarding the charitable deduction, which will provide a useful foundation to understanding the policy arguments that will follow. Section 170(a) of the Internal Revenue Code provides a

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1. *See* Janny Scott, *Charities Fail to Make Up for Lost Government Funds*, L.A. TIMES, Apr. 7, 1993, at A3 (stating that "'a thousand points of light' cannot be counted on to make up fairly for government cutbacks"). *But see* Gertrude Himmelfarb, *The Victorians Get a Bad Rap*, N.Y. TIMES, Jan. 9, 1995, at A15 (stating that charities, like those included in President George Bush's thousand points of light campaign, thrive in America).

2. *See* F. EMERSON ANDREWS, CORPORATION GIVING 36-39 (1952) (describing how private agencies provided relief to the needy in the depression years before federal and state relief programs took effect, and before the Internal Revenue Act of 1935 provided corporations with a charitable deduction).

3. *See* HAYDEN W. SMITH, COUNCIL FOR FIN. AID TO EDUC., A PROFILE OF CORPORATE CONTRIBUTIONS 7 (1983) (stating that an amendment in 1935 to the Internal Revenue Code provided an allowance for the deduction of corporate charitable contributions).

charitable deduction for both individuals and corporations.[4] There are some notable distinctions between how individuals and corporations are treated. I am going to go through this on a kind of Type A linear basis. According to the cash flow method of tax accounting, individuals can only take a deduction for a gift made in a specific year.[5] However, with accrual-basis accounting, corporations get the benefit of a special rule that allows a corporation's board, that has approved a charitable gift within a tax year, to actually make the gift up to three months after the close of that year.[6] To claim their deduction, the gift has to qualify as a charitable contribution under § 170(c) of the Internal Revenue Code.[7] This requires two things: that it be a contribution or a gift, something defined in case law and regulations, but not in the Code itself,[8] and that it be to one of five types of qualifying recipients.[9]

First, not all transfers are gifts. Some transfers are made with the expectation of a financial return and if that is the case, then a transfer is not considered a gift.[10] Those of you taking Tax 101 right now remember that *Commissioner v. Duberstein* makes this point.[11] The Code also requires you to choose your medicine. You cannot take a deduction for an expenditure as an ordinary and necessary business expense merely because it is cut off by the charitable deduction limitations that I will describe.[12]

4. *See* I.R.C. § 170(a) (1994).

5. *See id.* § 170(a)(1) (stating that "[t]here shall be allowed as a deduction any charitable contribution . . . payment of which is made within the taxable year").

6. *See id.* § 170(a)(2)(B) (stating that a corporation may elect to treat a contribution made on or before the 15th day of the third month following the close of the taxable year as paid during such taxable year).

7. *See id.* § 170(a)(1).

8. *See* Hernandez v. Commissioner, 490 U.S. 680, 690 (1989) (stating that "[t]he legislative history of the 'contribution or gift' limitation . . . reveals that Congress intended to differentiate between unrequited payments to qualified recipients and payments made to such recipients in return for goods or services"); *see also* Treas. Reg. § 1.170A-1(h)(1) (as amended in 1996) (stating that payments made by a taxpayer in consideration for goods or services are not considered contributions or gifts under § 170(c)).

9. *See* I.R.C. § 170(c) (1994).

10. *See* Commissioner v. Duberstein, 363 U.S. 278, 285-86 (1960) (holding that the transfer of a Cadillac from a corporation in return for names of potential customers is not a gift because it was not made out of affection, admiration, charity, or like impulses).

11. 363 U.S. 278, 285-86 (1960).

12. *See* I.R.C. § 162(b) (1994) (denying a deduction "for any contribution or gift which would be allowable as a deduction under section 170 were it not for the percentage limitations, the dollar limitations, or the requirements as to the time of payment, set forth in such section").

The second question that you have to answer in order to decide whether a gift is deductible, is whether the gift is made to a qualifying recipient.[13] Here, the rules for individuals track closely the rules for corporations, but they are again slightly different. First, you can make a gift to a state, a possession of the United States, or a political subdivision.[14] The most common type of gift to a political subdivision is a gift to a public school or to a volunteer fire department.[15] The language of the second type of qualifying recipient roughly tracks the language of § 501(c)(3),[16] which permits gifts to an organization that is organized and operated exclusively for religious, charitable, scientific, literary or educational purposes, along with some extra categories, such as sports organizations and societies for the prevention of cruelty to children and animals, thrown in.[17]

Now, as with the definition of § 501(c)(3), these categories are somewhat broader than they appear to be from the actual words. For example, the category "charitable," covers such broad areas as health care and low-income housing, as well as the more obvious gifts for care of the needy.[18]

The third and fourth types of organizations that qualified gifts can be made to are posts, veterans' organizations and fraternities, lodges, and similar associations.[19] The last category, which I would suspect is one of the rarest, is cemetery associations.[20] Unlike individuals, who have a fully articulated system of limitations on their deductions based upon the type

13. *See id.* § 170(c) (describing five types of qualifying recipients).

14. *See id.* § 170(c)(1).

15. *See* Phipps v. School Dist., 111 F.2d 393, 394 (3d Cir. 1940) (identifying school districts as political subdivisions of the state established for the purposes of administering the state's public school system); Scharf v. Commissioner, 32 T.C.M. (CCH) 1247, 1251 (1973) (holding that "[c]ontributions or gifts to a volunteer fire department are deductible under section 170(c)(1) on the ground that the volunteer fire department relieves a political subdivision of the burden of a function normally performed by the municipality").

16. *See* I.R.C. § 501(c)(3) (1994) (stating that organizations that are tax exempt are organizations operated for "religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster . . . sports competition, . . . or for the prevention of cruelty to children or animals").

17. *See id.* § 170(c)(2)(B).

18. *See* Sound Health Ass'n v. Commissioner, 71 T.C. 158, 177-79 (1978) (stating that although the Internal Revenue Code does not define the term charitable, "trusts for the relief of poverty and trusts for the promotion of health, both have been considered charitable").

19. *See* I.R.C. § 170(c)(3)-(4) (1994).

20. *See id.* § 170(c)(5).

of recipient,[21] whether it is a private foundation,[22] and whether it is a contribution of capital gain property,[23] corporations have a fairly simple regime. They can deduct up to ten percent of their taxable income.[24] Fairly enough, this is computed before reduction for the charitable gifts themselves. It is also computed without reference to certain net operating loss carry-backs,[25] which reinforces Hayden Smith's point that a corporation cannot make a gift if it does not have net income.[26] As with individuals, a carry-forward is available.[27] Corporations that were very generous in 1983, looking towards changes in tax law, had available to them a five year carry-forward that they could use up against unabsorbed parts of their corporate deduction limitations in succeeding years.[28]

A corporate donor has another restriction that does not apply to individual donors. If the corporate donor gives a gift to a foreign entity that is not a corporation, then it cannot claim a deduction when its contribution is used for activities conducted outside of the United States.[29] Reasonably enough, a corporation cannot claim a deduction for funding an organization's unrelated business activities.

Corporations make contributions in ways other than donating money.[30] For example, many corporations in New Haven, Connecticut have so-called community rooms where boards may meet, and where organizations may make presentations. However, under the language of § 170, gifts of the use of this space are not deductible gifts.[31] There may

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21. *See id.* § 170(b)(1)(A).

22. *See id.* § 170(b)(1)(E).

23. *See id.* § 170(b)(1)(C).

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

25. *See id.* § 170(b)(2)(C).

26. *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).

27. *See* I.R.C. § 170(d)(2) (1994) (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).

28. *See id.*

29. *See id.* § 170(c)(2) (stating that the contribution or gift to a trust, chest, fund, or foundation will only be deductible if it is used in the United States).

30. *See, e.g.*, Hildy J. Simmons, *Luncheon Speech*, 41 N.Y.L. SCH. L. REV. 1013 (1997).

31. *See* I.R.C. § 170(f)(3)(A) (1994) (stating that contributions, not made by a transfer in trust, of the right to use property which consists of less than the taxpayer's entire interest in such property are not allowed as a deduction under § 170); *see also*

be arguments as to whether the costs for that space are deductible as a business expense, under § 162.[32] However, I am not aware of any challenges to deductions for these gifts. Corporations also provide executives, secretarial help, and many other kinds of personnel support, to charities. This is also not reflected in the charitable deduction numbers, and may or may not produce an ordinary and necessary business expense deduction.[33] Corporations and individuals are subject to the same cutbacks on the worth of the charitable deduction when they give property that would have produced ordinary income or capital gains,[34] however, there are two special rules provided that are intended to give corporations an incentive to make contributions of inventory or research property.[35] That really sums up the basics of the § 170 rules, but there are two other areas I want to touch on very briefly.

An area of great interest to corporate givers is corporate sponsorship. This was a very difficult topic for the IRS for many years, though it was more difficult from the point of view of the charitable organization. The risk to the charitable organization that received large grants in order to fund a very big corporation bowl or a very big corporation gala event, was that this income would be treated as unrelated business income.[36] Generally, from the perspective of the giver, they had a choice of treating it as an ordinary and necessary business deduction to enhance their corporate reputation, or taking it as a charitable deduction.[37] There are now Treasury regulations which clarify this situation, and allow an organization to take this money, to make acknowledgments and recognition of the corporate givers, and, to oversimplify the rules that apply, they simply must avoid pushing product.[38] They can have a Cadillac in the middle of the football field during halftime, but they cannot say, "Cadillac is better than Ford." If the corporate sponsorship contract is geared to

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Treas. Reg. § 1.170A-7(a) (as amended in 1994).

32. *See generally* I.R.C. § 162 (1994) (allowing a deduction for ordinary and necessary business expenses).

33. *See id.* § 162(a)(1) (allowing a deduction for ordinary and necessary expenses paid or incurred in carrying on a business, including compensation for personal services actually rendered).

34. *See id.* § 170(e).

35. *See id.* § 170(e)(3)-(4).

36. *See id.* § 511(a)(1).

37. *See id.* §§ 162, 170 (allowing deductions for ordinary and necessary business expenses under § 162 and deductions for charitable contributions under § 170).

38. *See generally* Nathan Wirtschafter, Comment, *Fourth Quarter Choke: How the IRS Blew the Corporate Sponsorship Game*, 27 LOY. L.A. L. REV. 1465, 1466-67 (1994) (stating that in 1993 the Internal Revenue Service issued proposed regulations giving exempt organizations wide discretion in recognizing corporate sponsors).

attendance, geared to Neilsen ratings, or geared to a percentage of participants in the event, it will be treated as a business expense and not as a corporate gift.[39]

The last area I wish to touch on is regarding the creation of corporate foundations. A principal reason for their growth is that they are simply a vehicle to develop a corporate identity for giving and to make more rational choices from year to year. Unlike individuals, a corporation is not discouraged from giving to a private foundation. It is subject to the same deduction limitations, regardless of the flavor of § 501(c)(3),[40] and I would say it is safe to assume that corporations may feel they get more public relations bang-for-their-buck if they are using a coherent private foundation strategy to do this. There are some traps in that approach. Corporations must be aware of the self-limiting rules and they will have to carefully monitor that there are no transactions between the corporation and its own foundation other than the transfer of charitable gifts.[41] Tax 101 is now over.

39. *See* Treas. Reg. § 170A-1(e) (as amended in 1996) (stating that a deduction will not be allowed as a charitable deduction if the transfer is dependent upon the happening of a precedent event); *see also* Treas. Reg. § 1.162-20(a)(2) (as amended in 1995) (stating that expenditures that keep the taxpayer's name before the public are generally deductible as ordinary and necessary business expenses).

40. *See* I.R.C. § 170(b)(2) (1994).

41. *See id.* § 4941(a)(1) (imposing a tax on acts of self-dealing between a disqualified person, as defined in § 4946, and a private foundation).