

---

## The Paradox of Corporate Giving: Tax Expenditures, the Nature of the Corporation, and the Social Construction of Charity

Nancy J. Knauer

Follow this and additional works at: <https://via.library.depaul.edu/law-review>

---

### Recommended Citation

Nancy J. Knauer, *The Paradox of Corporate Giving: Tax Expenditures, the Nature of the Corporation, and the Social Construction of Charity*, 44 DePaul L. Rev. 1 (1994)

Available at: <https://via.library.depaul.edu/law-review/vol44/iss1/2>

This Article is brought to you for free and open access by the College of Law at Via Sapientiae. It has been accepted for inclusion in DePaul Law Review by an authorized editor of Via Sapientiae. For more information, please contact [digitalservices@depaul.edu](mailto:digitalservices@depaul.edu).

# THE PARADOX OF CORPORATE GIVING: TAX EXPENDITURES, THE NATURE OF THE CORPORATION, AND THE SOCIAL CONSTRUCTION OF CHARITY

Nancy J. Knauer\*

## TABLE OF CONTENTS

INTRODUCTION .....	3
I. CORPORATE GIVING: ITS SCOPE, HISTORY, AND TAX TREATMENT .....	12
A. <i>Statistical Overview of Corporate Charitable Giving</i> .....	12
B. <i>A Brief History of Corporate Giving and the Law</i> .....	15
1. <i>Corporate Giving and the Deduction</i> .....	15
(a) <i>Corporate Giving Prior to the Revenue Act of 1935</i> .....	16
(b) <i>The 1935 Enactment of the Corporate Charitable Contribution Deduction</i> ...	19
2. <i>The Ever-Changing Theory of Corporate Purpose</i> .....	20
(a) <i>Early Conceptions of Corporate Form and Purpose</i> .....	21
(b) <i>Corporate Purpose and the Berle-Dodd Debate</i> .....	22
3. <i>Theory, Doctrine, and the Courts</i> .....	23
4. <i>In Search of the Socially Responsible Corporate Citizen</i> .....	28

---

\* Assistant Professor of Law at Temple University School of Law. I would like to thank William J. Woodward, Jr., Scott Burris and Marina Angel for their encouragement and comments on this Article. For research assistance, I am indebted to Christine P. Jackson, Cheryl Siskin and Carole Sheffield. I presented a draft of this Article at a Temple University School of Law Faculty Colloquium, and I benefitted from the many thoughtful and helpful comments generated by the presentation. Finally, I am grateful to Temple University School of Law for the financial support it provided for this Article.

C.	<i>The Structure of the Federal Income Tax Corporate Charitable Contribution Deduction, Its Interpretation, and Its Limitations</i> . . . . .	32
1.	<i>Section 170: the Statute</i> . . . . .	33
2.	<i>The "Contribution or Gift" Requirement</i> . . . . .	35
	(a) <i>The Subjective Standard</i> . . . . .	37
	(b) <i>Hernandez and the Quid Pro Quo Standard</i> . . . . .	39
3.	<i>Intersection With the Section 162 Deduction for Ordinary and Necessary Business Expenses</i> . . . . .	41
	(a) <i>The Nondeductibility of Goodwill</i> . . . . .	43
	(b) <i>Transfers of Appreciated or Inventory Property</i> . . . . .	44
4.	<i>The Corporate Level Deduction</i> . . . . .	45
	(a) <i>A Constructive Dividend?</i> . . . . .	45
	(b) <i>Compensation to the Manager</i> . . . . .	48
II.	<b>CORPORATE GIVING: ITS MANY EXPLANATIONS AND MANIFESTATIONS</b> . . . . .	49
A.	<i>The "Halo Effect" and What Corporations Say They Expect to Get When They Give?</i> . . . . .	49
1.	<i>Tax Deductibility as the Sine Qua Non of Corporate Giving</i> . . . . .	49
2.	<i>The Perceived Business Benefit of Corporate Giving</i> . . . . .	53
3.	<i>The "Halo Effect"</i> . . . . .	57
B.	<i>The Discourse of Corporate Giving</i> . . . . .	60
1.	<i>Advertising and Marketing</i> . . . . .	60
	(a) <i>Cause-related Marketing</i> . . . . .	64
	(b) <i>Corporate Sponsorship</i> . . . . .	66
2.	<i>Goodwill &amp; Public Relations</i> . . . . .	71
3.	<i>Investment in the Future: Future Markets and Future Employees</i> . . . . .	75
4.	<i>The Delicate Balance Required</i> . . . . .	79
C.	<i>A Final Caveat - To Look Beyond the Stated</i> . . . . .	81
1.	<i>Dual Agenda or Hidden Agenda Giving</i> . . . . .	81
2.	<i>Corporate Giving as Social Currency</i> . . . . .	83
3.	<i>Corporate Giving as a Defensive Strategy</i> . . . . .	85
III.	<b>TAX EXPENDITURE ANALYSIS REDUX</b> . . . . .	88
	<b>CONCLUSION</b> . . . . .	93

## INTRODUCTION

Corporate charitable giving is big business. Fundraisers estimate that in 1992, U.S. corporations "contributed" \$6 billion<sup>1</sup> to qualified charitable organizations.<sup>2</sup> Hardpressed for funds, qualified charities actively seek and compete for corporate contributions.<sup>3</sup> Fundraising literature identifies corporate giving as the last great frontier of philanthropy.<sup>4</sup> Marketing literature touts corporate giving as the latest advertising and public relations technique.<sup>5</sup> Both camps proclaim that corporate giving is good for business and extol the business advantages which flow from transfers to charity.<sup>6</sup> In short, corporate giving means "doing best by doing good."<sup>7</sup>

Legal scholarship ignores the way corporate giving is described, justified, and expressed by those making the transfers (corporate managers) and those receiving the transfers (fundraisers).<sup>8</sup> Instead,

---

1. 1993 GIVING USA: THE ANNUAL REPORT ON PHILANTHROPY FOR THE YEAR 1992 10 (Anne E. Kaplan, ed. 1993) [hereinafter GIVING]. For a discussion of charitable giving statistics, see *infra* notes 59-72 and accompanying text.

2. This Article deals with corporate transfers to charitable organizations exempt from federal income tax under section 501(c)(3) and qualified to receive tax-deductible contributions under section 170 of the ~~Internal Revenue Code of 1986, as amended~~. Unless otherwise noted, all section references refer to the Internal Revenue Code of 1986, as amended, and the regulations thereunder. See *infra* notes 182-84 and accompanying text (describing in more detail the requirements for qualification and the general types of organizations which so qualify).

3. Fundraising literature is replete with helpful suggestions of how to secure corporate contributions. See *infra* notes 300-08 and accompanying text (discussing the fundraising literature).

4. As used throughout this Article, the term "marketing and fundraising literature" refers to a broad range of texts discussing the practice of corporate giving. Generally, the fundraising literature is directed to charities and offers advice concerning how to attract corporate funding. The most influential trade journal is *The Chronicle of Philanthropy*, a biweekly newspaper reporting on issues of interest to charitable organizations. Corporate giving is a popular topic. Marketing literature is directed toward corporate managers. Tips on corporate giving can be found in trade journals for various industries as well as in advertising journals. Both perspectives (how to attract corporate transfers versus how to make corporate transfers) discuss the business benefits associated with corporate giving.

5. See *infra* notes 273-332 and accompanying text (discussing the publicity benefits of corporate giving).

6. See *infra* notes 300-318 and accompanying text (discussing the perceived business benefits associated with corporate transfers to charity).

7. This phrase is the title of a particularly outspoken text written by two fundraising consultants who specialize in arranging corporate sponsorship programs. RICHARD STECKEL & ROBIN SIMONS, *DOING BEST BY DOING GOOD* (1992).

8. This Article refers to two general classes of individuals: corporate managers and fundraisers. The term corporate managers refers to corporate employees (they may or may not be shareholders in the corporation). Corporate managers vary considerably in rank and authority. They include corporate officers as well as public relations and corporate giving executives. Fundraisers are employed by the charitable organization to attract corporate (and individual or foundation) financial support. A third group of players consists of independent agents. Those retained by corporations

it presents the widespread practice of "corporate giving" as an apparent paradox: why would corporations give away \$6 billion in assets each year? It then typically analyzes this practice in terms of the theory of corporate purpose and federal tax policy.<sup>9</sup> Both approaches fail because they misapprehend the behavior they purport to explain. Both assume that the distinguishing feature of corporate giving is the absence of a quid pro quo; the absence of an expected commensurate benefit. Yet, this assumption is at odds with the contemporary understanding of corporate giving. Marketing and fundraising literature describes corporate giving in terms of "enlightened self-interest,"<sup>10</sup> making it clear that a corporate transfer to charity is "not altruistic; it is intensely self-interested."<sup>11</sup> Such transfers are made with the expectation of receiving a commensurate benefit in return.<sup>12</sup> The anticipated benefit ranges from immediate advertising and marketing services to long-term public relations and goodwill advantages.<sup>13</sup>

Legal scholarship, however, posits disinterested corporate giving

are advertising and marketing specialists who specialize in developing advertising or marketing programs centered on transfers to charitable organizations. Individuals retained by charitable organizations are typically referred to as fundraising consultants, some of whom may charge a fee based on a percentage of the funds they raise on behalf of the organization. *See, e.g., id.* at 260-61 (discussing the advantages and disadvantages of using consultants).

9. *See, e.g.,* William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261 (1992) (discussing the corporate theory approach); *see also*, E.C. Lashbrooke, Jr., *Internal Revenue Code Section 170 and the Great Corporate Giveaway*, 22 PAC. L. J. 221 (1991) (discussing a more tax-centered approach).

10. *See infra* note 149 (explaining that "enlightened self-interest" was coined by a witness in the landmark charitable giving case of *A.P. Smith Mfg. Co. v. Barlow*, 98 A.2d 581 (N.J. 1953)). The case established the propriety of corporate transfers to charity, thereby resolving any lingering concern that such transfers were ultra vires. *Id.* *See infra* notes 141-52 and accompanying text (discussing *A.P. Smith*).

11. Peter D. Hall, *Business Giving & Social Investment in the U.S. in PHILANTHROPIC GIVING: STUDIES IN VARIETIES AND GOALS* 221, 241 (Richard Magat ed., 1989) [hereinafter Hall, *Business Giving*].

12. Part II examines the practice of corporate giving as explained by corporate managers and fundraisers. Both groups detail the very tangible benefits that purportedly inure to a corporate donor. *See infra* notes 273-487 and accompanying text (discussing the many explanations for corporate giving). For example, *DOING BEST BY DOING GOOD* advised, "When corporations rub shoulders with nonprofits, something nice happens: the image of the nonprofit rubs off on the corporation. Corporations can take advantage of this by sidling up to nonprofits that have characteristics that they want for their own." STECKEL & SIMONS, *supra* note 7, at 15.

13. As discussed in Part II, this Article divides the perceived benefits into three general categories: advertising and marketing services, public relations efforts designed to enhance corporate goodwill, and long-term investments in future markets and future employees. The distinguishing feature among the three categories is how directly the corporation realizes the benefit. *See infra* notes 333-444 and accompanying text (discussing the three categories of perceived benefits associated with corporate giving).

— giving that is separate and distinct from all other, necessarily, self-interested corporate transfers.<sup>14</sup> This either/or construction of corporate giving is the unstated starting point for both the corporate theory or the tax policy approach analysis of corporate giving.

Under the corporate theory approach, corporate giving is measured against a particular theory of corporate purpose, such as profit maximization or corporate social responsibility.<sup>15</sup> If the purpose of the corporation is to maximize shareholder profit and gain,<sup>16</sup> then corporate giving represents a misuse of corporate funds. The profit maximization view of corporate purpose explains disinterested corporate giving as either the result of a misguided belief in corporate social responsibility,<sup>17</sup> or an attempt by corporate managers to further their class interests.<sup>18</sup> On the other hand, if the purpose of the corporation includes the advancement of broader societal interests,<sup>19</sup> then corporate giving is not only desirable, it is necessary. This view of the corporation points to judicial and legislative approval of corporate giving as acceptance of the social responsibility model of corporate purpose.<sup>20</sup>

The tax policy approach focuses on the incentive for corporate transfers<sup>21</sup> to certain qualified charitable organizations<sup>22</sup> provided in

---

14. See *infra* notes 198-213 and accompanying text (discussing disinterested corporate giving).

15. Legal scholarship evaluates corporate giving in terms of profit maximization or social responsibility. Accordingly, this Article focuses on profit maximization and social responsibility theories of corporate purpose. When the favorable federal tax treatment of corporate giving is analyzed historically it is clear that the tension between these divergent views of corporate purpose was at the forefront of contemporary legal thought.

16. See *infra* notes 120-52 and accompanying text (comparing the profit maximization model of corporate purpose to the social responsibility model).

17. See *infra* notes 120-52 and accompanying text (comparing the profit maximization model of corporate purpose to the social responsibility model).

18. See *infra* notes 455-68 and accompanying text (discussing the use of corporate transfers to charity as a form of "social currency" by corporate managers).

19. See *infra* notes 120-52 and accompanying text (comparing the social responsibility model of corporate purpose to the profit maximization model).

20. See *infra* notes 153-76 and accompanying text (discussing the desirability of socially responsible corporations). Under such a model, the danger of abuse by corporate managers may continue, but the underlying behavior is consistent with corporate purpose.

21. Beyond this simple encouragement, federal social policy constructed during the Reagan-Bush administrations both advocated and affirmatively relied on corporate funding of charitable activities. For example, President Bush's education reform initiative, the creation of the New American Schools Development Corporation ("NASDC"), was dependent upon corporate funding. See *infra* notes 415-19 and accompanying text (discussing the NASDC). The Clinton administration has continued this reliance on corporate funding of charitable activities (i.e., voluntary nontax revenue) in connection with its support the NASDC and its national service program. The National and Community Service Trust Act requires the establishment of an independent Federal corporation that will actively solicit corporate contributions. See National and Community Service

the form of an income tax deduction under section 170 of the Internal Revenue Code<sup>23</sup> for "charitable contributions."<sup>24</sup> Only corporate transfers to qualified charitable organizations made without the expectation of receiving a commensurate benefit qualify as a deductible "contribution or gift" under section 170.<sup>25</sup> Other transfers to charity may be deductible as ordinary and necessary business expenses under section 162.<sup>26</sup> Thus, federal tax policy assumes that there are two distinct types of corporate transfers to charity: one advances the corporate goal of social responsibility (section 170 contribution or gift), and the other furthers the goal of profit maximization (section 162 ordinary and necessary business expenses).

The proponents of corporate giving eschew such polarized views of corporate behavior. The articulated rationale for corporate giving effectively merges the two classic expressions of corporate purpose: profit maximization and social responsibility. Under the rubric of "enlightened self-interest," when a corporation makes a transfer to charity it advocates a model of corporate social responsibility, but it articulates the goal of profit maximization. By expressing corporate

---

Trust Act, Pub. L. No. 103-82, 107 Stat. 785 (1993).

22. This article uses the terms "qualified organization," "charitable organization" and "charity" interchangeably to mean organizations described under section 170(c) qualified to receive tax-deductible contributions and exempt under section 501(c)(3) from income tax imposed on income related to their exempt purpose. I.R.C. §§ 170(c), 501(c)(3) (1988). Current IRS statistics indicate that there are over 1,000,000 exempt organizations, 800,000 of which are qualified to receive tax-deductible contributions. Although section 170(c) lists various types of qualified organizations, this Article focuses on "charitable" organizations specifically defined under section 170(c)(2). See *infra* note 184 (quoting § 170(c)(2)).

23. I.R.C. § 170 (1988). The deduction reduces the after-tax cost of transfers to charity. The following example illustrates this reduction. Assume that a corporation's top marginal tax rate is 35%, as provided in section 11 of the Omnibus Budget Reconciliation Act of 1993. *Id.* § 11(b)(1)(D) (raising the top marginal rate of tax on corporate income from 34% to 35%). Assume a corporation transfers \$100x to a qualified charity. If the amount of the transfer is fully deductible in the year of the transfer, the corporation 'saves' the \$35x of tax that it otherwise would have paid with respect to the \$100x. The \$100x transfer to charity only 'costs' the corporation \$65x. Traditional tax policy analysis identifies this 'lost' \$35x as a tax expenditure in the form of foregone federal revenue. For an in depth discussion of the after-tax cost of corporate transfers to charity, see *infra* notes 177-272 and accompanying text. For a discussion of the tax expenditure theory, see *infra* notes 488-522 and accompanying text.

24. I.R.C. § 170(a)(1)(1988). See also *infra* note 182 (citing the relevant portions text of section 170(a)(1)).

25. I.R.C. § 170(c)(1988). See also *infra* note 184 (citing the relevant portions of the text of section 170(c)).

26. I.R.C. § 162 (1988). Section 162 provides a deduction for ordinary and necessary trade and business expenses. See *infra* notes 225-37 and accompanying text (discussing the relationship between the section 170 charitable contribution deduction and the section 162 business expense deduction).

giving in terms of the corporate bottom line, the paradox is seemingly resolved, and a profit maximization critique of corporate giving is deflected. Corporations do not give away assets.<sup>27</sup> To the contrary, corporate giving consciously tries to capitalize on the goodwill associated with social responsibility<sup>28</sup> and to use such charitable goodwill for corporate advantage. This commodification of charitable goodwill is known in the advertising and marketing industry as the "halo effect."<sup>29</sup>

The halo effect attaches to corporations that appear to give assets away to charity. The belief that a corporation can (and should) make disinterested transfers to charity has its origin in the social responsibility model of corporate purpose.<sup>30</sup> Although "social responsibility" is conspicuously absent from the marketing and fundraising literature, it is the stated rationale for the corporate charitable contribution deduction provisions under section 170,<sup>31</sup> as illustrated in the legislative history surrounding the enactment of the corporate charitable deduction in 1935<sup>32</sup> and its 1981 amendments.<sup>33</sup>

The historical context of the enactment of the corporate provisions of section 170 may explain the disjunction between the stated policy reasons for the deduction (i.e., encourage socially responsible behavior by corporations) and the present conception and practice of corporate giving (i.e., enlightened self-interest calculated to enhance

---

27. Corporations expect to receive a commensurate benefit in exchange for any transfer. *See infra* notes 300-332 and accompanying text (discussing the expectations of corporate managers). The commensurate benefit that corporations expect to receive is the result of the generally favorable public perception of transfers to charity (and charitable organizations), known as the "halo effect." *See infra* notes 319-32 and accompanying text (discussing the "halo effect").

28. Consumer surveys indicate that perceived acts of social responsibility carry wide public appeal and approval. *See infra* notes 300-08 and accompanying text (discussing marketing and fundraising literature which shows that corporate giving enhances image and increases profits). Despite this broad public appeal, the model of the socially responsible corporation has not withstood the criticisms of those who advance profit maximization as the only rational corporate goal. *See infra* notes 120-23, 133-39 and accompanying text (discussing scholarly and judicial criticism of the social responsibility model of corporate purpose).

29. *See infra* notes 319-32 and accompanying text (discussing the "halo effect").

30. *See infra* notes 124-26, 141-52 and accompanying text (discussing the social responsibility model of corporate purpose).

31. *See infra* notes 93-103 and accompanying text (discussing the 1935 enactment of the corporate charitable deduction).

32. Revenue Act of 1935, Pub. L. No. 74-407, 49 Stat. 1014 (adding subsection (r) to section 23 of the Revenue Act of 1934, thereby permitting a corporation to deduct charitable contributions to the extent of five percent of its income).

33. I.R.C. § 170(b)(2)(e)(4) (1988); *see also infra* notes 93-103 and accompanying text (discussing the 1935 enactment of the corporate charitable deduction).



profit maximization).

Congress enacted the corporate charitable deduction in 1935 during a period of economic instability when the Federal government significantly increased its involvement in the provision of social services.<sup>34</sup> On a practical level, it was in the best interest of the federal government to encourage private philanthropy, and the government actively solicited assistance from the private sector.<sup>35</sup> The enactment of the deduction provided an incentive for corporate transfers to charity.<sup>36</sup> The fact that the deduction applied to a corporate "contribution or gift" added a charitable gloss to such transfers.

In legal scholarship, the debate between Professors Berle and Dodd over the nature of corporate powers<sup>37</sup> had transformed the prevailing notion of corporate purpose and yielded a new concept of the socially responsible corporation.<sup>38</sup> This new concept of social responsibility added rhetorical force to the federal government's request for corporate support. Both the theory and the deduction served to legitimize corporate transfers to charity that were declared *ultra vires* under the laws of many states.<sup>39</sup>

The initial appearance of social responsibility in the federal tax code<sup>40</sup> may have been driven by the federal government's pragmatic

---

34. See *infra* notes 93-103 and accompanying text (discussing the 1935 enactment of the corporate charitable deduction).

35. See, e.g., *infra* note 158 (discussing Congressional support for corporate generosity).

36. For a brief history of the enactment of the corporate charitable contribution deduction, see *infra* notes 93-103 and accompanying text.

37. The result of the Berle-Dodd debate was the application of trust principles to corporate powers, specifically that the powers of corporate managers or officers were fiduciary powers. The disagreement between Professor Berle and Professor Dodd centered on the class of individuals (or interests) to whom the corporate managers owed a fiduciary duty. Professor Berle proposed the application of trust principles to corporate powers in order to address the divergence of corporate control from ownership documented in his earlier study co-authored with Professor Means. ADOLPH A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932). See *infra* notes 120-23 and accompanying text (discussing Professor Berle's profit maximization theory of corporate purpose). Professor Berle theorized that corporate managers held corporate powers in trust for the shareholders. Professor Dodd simply expanded this view with the notion that corporate powers were held in trust not only for shareholders, but also for broader societal interests. See *infra* notes 124-26 and accompanying text (discussing Professor Dodd's social responsibility theory of corporate purpose).

38. See *infra* notes 153-76 and accompanying text (discussing the "socially responsible corporate citizen").

39. As discussed in Part I Section B, in 1935 corporate transfers to charity were considered *ultra vires* and, therefore, void under the laws of many states. Legislation and judicial decisions eventually authorized corporate transfers to charity. See *infra* notes 73-103 and accompanying text (discussing legislative attitudes toward a deduction for corporate charitable contributions).

40. This historical context does not explain the continued prevalence of social responsibility language in connection with the 1981 amendments. See *infra* notes 182-87 and accompanying text

goal to attract corporate funding for social programs. This pragmatism not only explains the continued existence of a corporate charitable contribution deduction that is rooted in outdated theories of corporate purpose,<sup>41</sup> but perpetuates the belief that corporations make disinterested transfers to charity.

The "socially responsible" behavior that the corporate section 170 deduction purports to encourage bears little resemblance to the "enlightened self-interest" that the deduction subsidizes. The effect of this mischaracterization is twofold: (i) the deduction adds a charitable gloss to transfers that corporate managers and the fundraisers understand as a corporate "purchase of goodwill,"<sup>42</sup> and (ii) the stated policy reasons for the deduction misdirect any tax expenditure analysis of corporate giving.<sup>43</sup>

Corporate giving, as the natural expression of "enlightened self-interest," is the antithesis of the type of transfer deemed deductible as a charitable contribution under section 170. To qualify for the deduction, a transfer must constitute a "contribution or gift,"<sup>44</sup> and it must be "to or for the use of"<sup>45</sup> an organization described in section 170(c).<sup>46</sup> Neither a common sense reading of the phrase "contribution or gift" nor its present judicial interpretation encompasses anything as calculated as "enlightened self-interest."<sup>47</sup> Because corporate giving is inherently self-interested, a corporate transfer to charity cannot qualify as a "contribution or gift" under section 170. This notwithstanding, each year corporations deduct billions of dol-

---

(discussing the corporate charitable contribution deduction provision).

41. Although the theory of social responsibility has not fared well over the years, the federal government does remain very interested in encouraging corporate support of social programs, as evidenced by the language of section 170. I.R.C. § 170 (1988). See *infra* notes 177-87 and accompanying text (discussing section 170).

42. Even the Treasury Department agrees with the characterization of corporate transfers to charity as the "purchase of goodwill." In connection with proposed regulations regarding the allocation of corporate charitable contribution deductions against foreign source income under section 861, the Treasury Department unequivocally stated that corporate transfers to charity represented a "purchase of goodwill" in the country in which they were used. See *infra* note 392.

43. For a discussion of the tax expenditure theory, see *infra* notes 488-522 and accompanying text.

44. I.R.C. § 170(c) (1988). For a detailed discussion of the statutory provisions of section 170, see *infra* notes 182-87 and accompanying text.

45. I.R.C. § 170(c) (1988); see *infra* notes 182-224 accompanying text (discussing which transfers qualify as charitable contributions for purposes of tax deduction).

46. See *infra* notes 182-84 and accompanying text (discussing the types of organizations which qualify under section 170(c)).

47. Generally, the deductibility of a transfer as a charitable contribution under section 170 is determined by the nature of the transfer and the status of the donee. See I.R.C. § 170(c) (1988).

lars under section 170.<sup>48</sup>

The fact that the federal tax code purports to distinguish true corporate giving from other business expenses<sup>49</sup> reinforces the "halo effect." One way to help untangle the misconceptions surrounding corporate giving would be to repeal the corporate deduction provisions of section 170. Such repeal would tarnish, if not remove, the charitable halo under which corporations now actively trade.<sup>50</sup>

In the absence of the corporate charitable contribution deduction most transfers to charity would be deductible under section 162 as ordinary and necessary business expenses.<sup>51</sup> This ability to substitute a section 162 deduction<sup>52</sup> (albeit imperfectly)<sup>53</sup> for a section 170 deduction satisfies unstated policy reasons for the continuation of the deduction, such as the need to raise corporate nontax revenue to fund certain charitable and/or governmental activities. If Congress perceives a need to provide greater incentives for such transfers, it should clearly articulate the need and address it without the charitable gloss provided by locating the deduction within section 170.

The second effect of the mischaracterization of corporate trans-

48. For a discussion of IRS statistics on corporate giving, see *infra* notes 59-72.

49. To a large extent our contemporary understanding of charity is defined by reference to organizations qualified to receive tax-deductible contributions under the applicable provisions of the federal tax code. The influence of the federal tax code is so pervasive in the charitable arena that legal scholars and economists consistently explain and analyze corporate giving in terms of its favorable tax treatment. The "halo effect" is reinforced, and perhaps to some extent constructed, by the very provision under which corporate transfers to charity are improperly characterized. See *infra* notes 182-87 and accompanying text (discussing the section 170 corporate charitable deduction provision).

50. As discussed in Part II, Section C, the "halo effect" may provide more than a simple marketing advantage: it may represent an avenue through which corporations use "enlightened self-interest" to obtain and exercise corporate (managerial) political, social, and economic power. See *infra* notes 319-32 and accompanying text (discussing the "halo effect"); see also *infra* notes 141-52 and accompanying text (discussing "enlightened self-interest").

51. Current federal tax law recognizes that certain transfers qualify under both sections 162 and 170. Section 162(b) provides that in such circumstances section 170 takes priority. This is to prevent a taxpayer from avoiding the ceiling limitations imposed on charitable contributions. I.R.C. § 162(b) (1988). Section 162 deductions are not subject to comparable limitations. See *infra* notes 225-37 and accompanying text (discussing the relationship between the section 170 corporate contribution deduction and the section 162 business expense deduction).

52. The substitution effect illustrates that the continued deductibility of corporate transfers to charity does not represent a significant loss in federal revenue nor would its repeal significantly increase federal revenue. See *contra* Lashbrooke, *supra* note 9, at 248 (advocating the repeal of the corporate charitable deduction).

53. In certain instances, corporate transfers to charity are afforded more favorable tax treatment than section 162 deductions. For example, transfers which qualify under section 170 are immediately deductible and need not be capitalized. In addition, certain transfers of property are subject to more favorable tax treatment if they are characterized as a section 170 contribution rather than a section 162 business expense. See *infra* notes 225-37 accompanying text.

fers to charity is a distortion of the tax expenditure analysis of the federal budget.<sup>54</sup> In practice, corporate managers and fundraisers agree that corporate transfers to charity represent a calculated purchase of advertising services or goodwill. Thus, the budgeted tax expenditure for corporate giving (i.e., the corporate charitable contribution income tax deduction under section 170) subsidizes a corporate "purchase of goodwill" — something very different from the type of corporate transfer envisioned by the "contribution or gift" requirement of section 170.<sup>55</sup> Once a corporate transfer to charity is recast as a corporate purchase of goodwill, a deduction for such transfers becomes a normative adjustment and not a tax expenditure.<sup>56</sup> Although this conclusion may seem anticlimactic, it focuses attention on the second federal tax subsidy that such transfers receive: the donee charity is exempt from federal income tax upon the receipt of the transfer.<sup>57</sup> If a corporate transfer to charity is a purchase of goodwill, then the transfer should represent unrelated business income taxable to the donee charity. This raises many questions for additional research and study.<sup>58</sup>

This article examines and documents why corporations make transfers to charity. Part I provides a historical background of corporate giving, particularly the evolution of the theory of corporate purpose and the gradual doctrinal acceptance of corporate giving. It also describes the structure of the current federal income tax treatment of corporate transfers to charitable organizations, including the ability to "substitute" section 162 deductions for section 170 deductions. Part II reviews the various explanations for corporate giving. At the outset, it rejects the prevailing tax-centered explanations advanced by legal scholarship and econometric research. It then examines the current understanding of corporate giving, as expressed

---

54. For a discussion (and critique) of the traditional tax expenditure theory, see *infra* notes 488-522 and accompanying text.

55. See *infra* notes 188-224 and accompanying text (discussing the "contribution or gift" requirement).

56. Obviously, this assumes that one accepts the basic premise of the tax expenditure theory that certain deductions represent normative adjustments to the tax base. All other deduction, credits and exclusions are tax expenditures representing an indirect federal subsidy.

57. This means that corporate transfers to charity characterized as "contributions" are not only deductible to the corporation, but also are exempt from tax action when received by the donee charity. Generally, a qualified charity is subject to federal income tax on business income that is not substantially related to its charitable purpose (i.e., unrelated business income as defined under section 511). See *infra* notes 508-11 and accompanying text.

58. For a discussion of the potential areas for future study, see *infra* notes 523-43 and accompanying text.

in marketing and fundraising literature, and reveals a pervasive belief that corporate giving is good for business. Central to this belief is the commodification of charitable goodwill — the “halo effect.” This Part contrasts the federal income tax characterization of corporate transfers to charity with an in-depth discussion of three different categories of corporate giving: (i) advertising and marketing services, (ii) public relations, and (iii) investment in future markets and future employees. Part II concludes with the caveat that conclusions based on marketing and fundraising literature are incomplete because they represent the articulated reasons of the proponents of the behavior. As such, there may be alternative (and unspoken) explanations for corporate transfers to charity, such as the ability of corporations to exercise social and political power. Part III discusses the tax expenditure theory of deductions and recasts the analysis of the corporate charitable contribution deduction as an indirect federal subsidy for the corporate purchase of advertising or public relations services. Thus, Part III takes the corporate charitable deduction outside the realm of the tax expenditure budget, and sets the stage for future research into the tax treatment of corporate funding in the hands of the donee charity.

## I. CORPORATE GIVING: ITS SCOPE, HISTORY, AND TAX TREATMENT

### A. *Statistical Overview of Corporate Charitable Giving*

Fundraisers estimate that corporations transferred \$6 billion to qualified charities in 1992.<sup>59</sup> This figure does not include grants paid by corporate charitable foundations, but it does include contributions from corporations to their foundations.<sup>60</sup> In 1992, corporate

---

59. GIVING, *supra* note 1, at 10. *The Annual Report* is prepared annually by American Association of Fund-Raising Counsel, Inc. and is based on reports from corporations themselves. The most recent Internal Revenue Service (“IRS”) statistics on charitable giving relate to 1989. *Internal Revenue Service, Statistics of Income — 1989 Corporation Income Tax Returns*. IRS figures include only amounts reported as charitable contribution deductions on corporate federal income tax returns. Given that corporations may make transfers to charity that they do not claim as a charitable deduction, IRS statistics undercount the actual level of corporate transfers to charitable organizations. See Hayden W. Smith, *Corporations Are More Generous Than You Think*, THE CHRON. OF PHILANTHROPY, Oct. 22, 1991, at 37 (discussing the flaws in the IRS statistics).

60. In any discussion of corporate giving, it is important to understand the distinction between direct corporate funding of charitable activities and distributions from corporate charitable foundations. The latter are separate nonprofit corporate entities organized and operated for charitable purposes. Corporate charitable foundations are exempt from federal income tax and eligible to receive tax-deductible contributions. This distinction is often overlooked. For example, Professor

charitable foundations made grants totaling \$3.2 billion to support various charitable projects.<sup>61</sup>

Much to the disappointment of charities,<sup>62</sup> the 1992 level of corporate giving was less than the 1991 level. For the first time in years,<sup>63</sup> the level of corporate giving did not keep pace with the rate

Green cited examples of grants made by corporate foundations rather than direct corporate giving to illustrate the type of charitable endeavors funded by corporate transfers. Shelby D. Green, *Corporate Philanthropy and the Business Benefit: The Need for Clarity*, 20 GOLDEN GATE U. L. REV. 239, 259-60 (1990) (urging uniformity in the rules governing corporate transfers to charity). Although one could argue persuasively that corporate charitable foundations are indeed corporate agents, such an argument requires a much more detailed analysis than is possible within the context of this Article. This Article discusses only direct corporate transfers to charity, but as such includes corporate transfers to charitable foundations.

61. GIVING, *supra* note 1, at 74. Corporate charitable foundations are subject to the private foundations rules and are required to disburse a certain percentage of their assets annually for charitable purposes in order to qualify for exemption and avoid excise taxes. IRC § 4701 (1988). Generally, a 'private foundation' is a sub-category of exempt organizations. An organization is classified as a private foundation if it is not "publicly supported (does not receive contributions from a number of donors), it does not receive a substantial amount of its revenue from the performance of its exempt function (e.g., hospital and nursing homes), and it is not closely-related to a 'publicly-supported' organization." Classification as a private foundation is considered less-favorable because private foundations are subject to a host of excise taxes, are subject to more restrictive rules than other charities, and are subject to additional oversight of their activities. See BRUCE R. HOPKINS, *THE LAW OF TAX-EXEMPT ORGANIZATION* 429-611 (1987).

62. Smith, *supra* note 59, at 38 (discussing charities' responses to the apparent reduction in corporate giving).

63. IRS statistics on corporate transfers to charity are not available for years after 1988. IRS figures undercount the total corporate transfers to charity. See *supra* note 59. For this reason, as well as the lack of recent IRS data, this article uses the estimates of corporate giving prepared by fundraising associations. The American Association of Fund-Raising Counsel, Inc. estimates of corporate charitable giving (in billions of 1992 dollars) as follows:

1980	4.31	1985	6.78
1981	4.81	1986	6.83
1982	5.31	1987	7.01
1983	5.73	1988	6.83
1984	6.41	1989	6.67
		1990	6.42
		1991	6.24
		1992	6.000

GIVING.. *supra* note 1, at 16-17.

For purposes of comparison, the following IRS statistics note the amount of reported corporate charitable contribution deductions (in billions of dollars):

1980	2.355	1985	4.472
1981	2.514	1986	5.179
1982	2.906	1987	4.980
1983	3.627	1988	4.893
1984	4.057	1989	TBA

Hayden W. Smith, *Corporate Giving Still Stalled: Inflation Outpaced Company Gifts for Third Year*, THE CHRON. OF PHILANTHROPY, Oct. 22, 1991, at 1, 10.

of inflation.<sup>64</sup> While corporate giving may be currently stalled at \$6 billion, in prior years the amount of corporate transfers to charity increased steadily.<sup>65</sup> Until 1992, corporate transfers to charity increased annually despite inconsistent trends in corporate pre-tax income.<sup>66</sup> Such increases occurred despite predictions by economists that corporate giving would decline in response to the lowering of corporate federal income tax rates by the 1986 Tax Reform Act.<sup>67</sup>

Fundraising literature identifies corporate giving as the last great frontier of philanthropy.<sup>68</sup> Seminars, pamphlets, and books offer fundraisers helpful hints on how to lure corporate transfers.<sup>69</sup> The emphasis on corporate giving appears disproportionate when measured against the \$101.83 billion that fundraisers estimate individuals gave to charitable organizations in 1992.<sup>70</sup> However, it is corpo-

64. See Smith, *supra* note 59, at 38 (comparing the rate of corporate giving with the rate of inflation).

65. An interesting anomaly is the increase in 1986, followed by a measurable decrease in 1987. Under the Tax Reform Act of 1986, the top marginal corporate tax rate decreased from 46% to 34%. In order to maximize the tax benefit of transfers to charity, fundraisers and tax planners urged corporations to "prepay" future transfers by increasing 1986 transfers. In addition, a special rule permits corporations to treat as paid in the prior tax year contributions paid in the current tax year. See *infra* note 183.

66. Corporate pre-tax income (in billions of \$):

1980	240.9	1987	287.9
1981	228.9	1988	347.5
1982	176.3	1989	342.9
1983	210.7	1990	355.4
1984	240.5	1991	334.7
1985	225.0	1992	371.6
1986	217.8		

GIVING.. *supra* note 1, at 106.

67. As discussed in Section A of Part II, Clotfelter concluded that "based on available econometric evidence," the reduction in the top marginal corporate tax rate from 46 percent to 34 percent and "the resulting increase in the net cost of making gifts will result in a modest decline in corporate giving, on the order of 5%." Charles T. Clotfelter, *Federal Tax Policy and Charitable Giving*, in PHILANTHROPIC GIVING: STUDIES IN VARIETIES AND GOALS *supra* note 11, at 105, 115.

68. See *infra* notes 300-08 and accompanying text (discussing marketing and fundraising literature)

69. See *infra* notes 290-93 and accompanying text (discussing Clotfelter's projections).

70. Individual charitable giving (in billions of dollars):

1980	40.71	1987	72.32
1981	45.99	1988	80.07
1982	47.63	1989	87.75
1983	52.06	1990	91.00
1984	54.46	1991	95.32
1985	58.66	1992	101.83
1986	67.63		

rate giving, accounting for only 4.8% of total charitable giving<sup>71</sup> which has captured the imagination of fundraisers.<sup>72</sup>

## B. A Brief History of Corporate Giving and the Law

### 1. Corporate Giving and the Deduction

During the years before the enactment of the deduction, corporations made transfers to charity without any tax incentive, and in many states, without legal authority.<sup>73</sup> When Congress enacted the corporate charitable contribution deduction provisions, it was encouraging behavior that was ultra vires under state law.<sup>74</sup> Therefore, individuals lobbying in favor of the deduction sought not only favorable tax treatment but also a subtle legitimization of corporate giving. The new legitimacy provided by the deduction was not lost on legislators and judicial decisionmakers.<sup>75</sup> Eventually, all states

---

GIVING, *supra* note 1, at 20-21 (does not include the dollar value of volunteer labor).

71. Fundraisers estimate that total charitable giving in 1992 was \$124.31 billion. The sources were:

	<u>\$(billions)</u>	<u>% of total</u>
Individuals	101.83	81.92
Bequests	8.15	6.56
Foundations	8.33	6.70
Corporations	6.00	4.83
TOTAL	124.31	100.0

*Id.* at 20-21.

Unlike individuals, corporations make almost no contributions to religious organizations. CHARLES T. CLOTFELTER, *FEDERAL TAX POLICY AND CHARITABLE GIVING* 173 (1985) (citing 1980 statistics estimating that corporate giving to nonreligious organizations was "about a sixth the size of individual giving [to nonreligious organizations]"). Consequently, corporate giving represents approximately 20% of secular charitable giving.

72. The federal government has also expressed interest in encouraging corporate funding of charitable endeavors. *See infra* notes 415-19 and accompanying text (discussing the new reliance of federal programs on corporate funding).

73. *See infra* notes 77-92 and accompanying text (discussing corporate giving prior to the enactment of the charitable deduction).

74. After World War I, many states passed legislation authorizing corporations to make gifts to charity. Texas and New York were the first states to enact such legislation. Barry D. Karl, *The Evolution of Corporate Grantmaking In America*, in *THE CORPORATE CONTRIBUTIONS HANDBOOK* 20, 28 (James P. Shannon, ed., 1991) ("Wartime legislation in the states of Texas and New York permitted gifts by corporations . . ."). Writing in 1956, Richard Eells reported, "[t]hree-fourths of the states and the Territory of Hawaii have adopted, in one form or another, such permissive legislation." RICHARD EELLS, *CORPORATION GIVING IN A FREE SOCIETY* 17 (1956). Eells also reported that the American Bar Association proposed an amendment to the Model Corporation Act in 1950 authorizing corporations to make donations to charity. *Id.*

75. Later cases approved corporate contributions citing, *inter alia*, the strong public policy to uphold (and encourage) such transfers as evidenced by the federal tax deduction. Green, *supra*



and the District of Columbia passed legislation permitting corporate contributions.<sup>76</sup>

(a) Corporate giving prior to the Revenue Act of 1935

Congressional testimony in support of a corporate deduction pointed to World War I as the beginning of a widespread practice of corporate giving.<sup>77</sup> This view of the history of corporate giving enabled the proponents of the corporate contribution deduction to explain its absence in the 1917 Revenue Act (i.e., there was no reason to provide a deduction for behavior which did not exist).<sup>78</sup> However, this explanation ignored the then-existing pattern of corporate giving. For example, during the late nineteenth century, railroads made transfers to Young Men's Christian Associations along the expanding rail routes to provide needed housing for the railroad workers.<sup>79</sup> In 1917, the year Congress enacted the individual deduction,<sup>80</sup>

note 60, at 249-54.

76. In addition, the 1992 Proposed Final Draft of the Corporate Governance Project of the American Law Institute provides that the primary purpose of the corporation is to 'enhance' corporate profit and shareholder gain. *Id.* at 242. Section 2.01(c) of the Proposed Final Draft recognizes that a corporation has the power to make 'reasonable' gifts. *Id.*

77. Congressional testimony presented a standardized version of the history of corporate giving. For example, one witness explained:

Before the World War corporation contributions were an exceptional occurrence in this country. They were so exceptional that the omission of their right of deduction in the original income war taxes is not surprising. The war developed these contributions immensely and community chests . . . have continued to secure these contributions until they amounted to 22 percent of all contributions to community chests in 1929.

*Revenue Act of 1934: Hearings Before the Senate Finance Comm.*, 73d Cong., 2d Sess. 136-37 (1933-34) [hereinafter *Hearings*] (statement of Allen T. Burns, executive director of the National Association of Community Chests).

The following year, Frederic B. Kellogg submitted a similar statement to the House Ways and Means Committee noting that "the practice of generous and wide-spread corporation contributions began in the war and continued ever since." *Proposed Taxation of Individual and Corporate Incomes, Inheritances, and Gifts: Hearings Before the House Comm. on Ways and Means*, 74th Cong., 1st Sess. 120 (1935) [hereinafter *Proposed*] (statement of Frederic R. Kellogg, President of Community Chests and Councils, Inc.). See also *Report on the Revenue Revision Act of 1927-28: Hearings Before the House Comm. on Ways and Means*, 69th-70th Congs., 102 (1927) [hereinafter *Report*] (statement of Congressman Carl R. Chindblom) ("As a matter of history you will find that very little of this charity work was done by corporations before the war.").

78. See *infra* notes 86-87 and accompanying text (discussing the ultra vires nature of corporate giving and the consequential lack of such activity).

79. F. EMERSON ANDREWS, *CORPORATION GIVING* 24 (1952). The early history of corporate giving involved public projects which were directly related to the well-being of the corporation's employees. See *id.* (discussing railroad transfers to the YMCA to benefit their employees); see also Karl, *supra* note 74, at 25 (discussing Young Men's Christian Associations).

80. Congress enacted the individual charitable contribution deduction in 1917. War Revenue Act of 1917, Pub. L. No. 65-50, 40 Stat. 300 (1917). The Tariff Act of 1913, did not include a

corporate transfers to the American Red Cross alone totaled \$17,948,696.<sup>81</sup> Despite this sizeable amount of corporate giving, the War Revenue Act of 1917<sup>82</sup> limited the charitable deduction to individuals. The stated rationale was to reduce the cost of charitable giving<sup>83</sup> in the face of higher wartime tax rates.<sup>84</sup> Legislative history also suggests that lawmakers believed that the charitable sector could provide social services more efficiently than the federal government.<sup>85</sup>

Congress debated and rejected a corporate deduction in 1919, 1928, and again in 1934. In each case, Congress expressed reluctance to encourage behavior prohibited by state law.<sup>86</sup> The ultra vires nature of corporate transfers to charity also presented a chal-

---

deduction for individual charitable contributions although an amendment to provide a deduction was introduced. The Tariff Act of 1913, Pub. L. No. 63-16, 38 Stat. 114 (1913). Congressman Rogers introduced an amendment providing a "deduction for gifts made by individuals to charitable, benevolent and religious societies," but it was not approved. 50 CONG. REC. 1259 (1913) (statement of Cong. Rogers).

81. ANDREWS, *supra* note 79, at 28 (citation omitted) (noting that in 1917, a significant number of corporations made direct contributions to charity). See generally *Hearings, supra* note 77, at 135-37 (discussing corporate charitable contributions from 1917 to the late 1920's).

82. War Revenue Act of 1917, Pub. L. No. 65-50, 40 Stat. 300 (1917). The Revenue Act of 1917 increased the rate of tax in order to raise revenue to fund the war effort. *Id.*

83. For a discussion of the effect of tax rates on the cost of charitable giving, see *infra* notes 177-81 and accompanying text.

84. Senator Hollis explained the need for the deduction in the following terms: "usually people contribute to charities . . . out of their surplus. . . when war comes and [Congress] impose[s] these very heavy taxes on incomes, that will be the first place where the wealthy men will be tempted to economize . . . in donations to charity." Senator Hollis ended his quote with, "[t]hey will say, 'Charity begins at home.'" 55 CONG. REC. 6728 (1917) (statement of Sen. Hollis). After concluding his remarks, Senator Hollis introduced into the Congressional Record a series of letters and editorials in favor of the deduction. *Id.*

85. Senator Hollis, without any thought that a charitable organization could have administrative expenses, optimistically stated, "for every dollar that a man contributes for these public charities . . . the public gets 100 percent; it is all devoted to that purpose." *Id.* (statement of Sen. Hollis). Obviously, this view is overly simplistic. Recent horror stories reporting excessive executive compensation and perks, such as the United Way scandal, have shaken public confidence in charitable organizations. For a discussion of the United Way scandal, see *infra* note 322.

86. The ultra vires nature of corporate transfers to charity was frequently discussed in connection with the legislative proposal to permit a deduction for such transfers. For example, in response to the 1928 proposal to enact the corporate deduction, Congressman John N. Garner argued strenuously against encouraging corporations to "handle the stockholders' money to the extent of giving it away for charitable . . . purposes[.]" He demanded "to know under what law corporations are authorized to make donations." 101 House Ways and Means Committee Revenue Revisions 1927-1928. *Report, supra* note 77, at 101 (statement of John N. Garner).

Senator David A. Reed voiced a similar sentiment when he questioned a representative of the National Retail Dry Goods Association as to whether Congress "should encourage officers of corporations to be charitable with other people's money." 1928 Act, *Revenue Act of 1928: Hearings Before the Senate Comm. on Finance*, 70th Cong., 1st Sess. 204 (1928) (statement of Sen. David A. Reed).

lence to charities which sought to attract and increase corporate support.<sup>87</sup>

One way charities dealt with the ultra vires issue was to characterize the transfer to charity as a foregone dividend. During World War I, the American Red Cross launched the first national corporate giving initiative and asked U.S. corporations to institute a "Red Cross Dividend" program.<sup>88</sup> The "Red Cross Dividend" was an innovative approach to corporate giving designed to circumvent the state ultra vires laws.<sup>89</sup> A participating corporation requested each of its individual shareholders to authorize the corporation to donate all or a portion of the shareholder's dividend to the American Red Cross.<sup>90</sup> Thus, the corporation had the requisite authority to transfer corporate funds to charity. The corporate participant was, as stated in the sample board resolution circulated by the American Red Cross, simply "enabling stockholders to contribute a portion of their distributive interest in [the] corporation . . . ."<sup>91</sup>

Outright corporate transfers to charity continued to increase after the war. Advocates for the corporate charitable deduction reported that in 1929 corporate giving accounted for approximately twenty-two percent of the total funds raised by community chests. Advocates of the deduction also boasted that corporations had given as much as \$12 million to community chests.<sup>92</sup>

87. See generally *infra* notes 273-444 and accompanying text (discussing the benefits of corporate charitable giving).

88. ANDREWS, *supra* note 79, at 26-28 (reporting that 148 corporations participated in the program); see also Karl, *supra* note 74, at 27 (stating that the "'Red Cross dividend' enabled companies to request authorization from stockholders for a special dividend to be contributed to the Red Cross").

89. The American Red Cross circulated a sample corporate resolution adopting the program. The resolution read in pertinent part:

Whereas, the Board of Directors of this Company believes that in this time of war generous contributions should be made to the Red Cross, by individuals, partnerships, corporations and other associations throughout the country, not only as obvious measures of humanity but also as great and most important parts in the preservation of the social and business structure of this country and other countries, and it is accordingly the belief of the Board of Directors of this Company that it should aid as substantially as possible in this effort by enabling stockholders to contribute a portion of their distributive interest in this corporation to those purposes.

ANDREWS, *supra* note 79, at 27.

90. The practice is similar to the shareholder giving program instituted by Berkshire Hathaway program. For a discussion of the Berkshire Hathaway program, see *infra* notes 267-68 and accompanying text.

91. ANDREWS, *supra* note 79, at 27.

92. Oddly enough, the testimony did not specify the year or years in question. See NEIL J. MITCHELL, *THE GENEROUS CORPORATION: A POLITICAL ANALYSIS OF ECONOMIC POWER* 20

(b) The 1935 enactment of the corporate charitable contribution deduction

Congress finally enacted the corporate charitable contribution deduction in 1935,<sup>93</sup> after years of lobbying efforts<sup>94</sup> by numerous business leaders and fundraisers.<sup>95</sup> President Franklin D. Roosevelt initially opposed the corporate charitable deduction because "corporations should not be able to 'purchase' goodwill and . . . charitable contributions were properly the domain of shareholders."<sup>96</sup> The official statement of the minority Republicans reported that Congress incorporated the deduction in the 1935 Tax Act "over the objection of our President."<sup>97</sup>

This new deduction was approved at a time when the federal government was assuming a greater role providing social services and regulating the economy,<sup>98</sup> the business community was struggling through the Great Depression,<sup>99</sup> and legal scholars were debating

(1989) (stating that corporate contributions to community chests increased during the 1920's to almost \$13 million).

93. Revenue Act of 1935, Pub. L. No. 74-407, 49 Stat. 1014 (adding subsection (r) to section 23 of the Revenue Act of 1934, thereby permitting a corporation to deduct charitable contributions to the extent of 5% of its income).

94. Congress debated a bill allowing a corporate charitable contribution deduction in connection with the passage of the 1919 Revenue Act and it expressly rejected the proposal. Karl, *supra* note 74, at 28. A similar bill was introduced in connection with the 1928 and 1934 Revenue Acts. Revenue Act of 1928, Pub. L. No. 562-70, 45 Stat. 791 (1928); Revenue Act of 1934, Pub. L. No. 216-73, 48 Stat. 680 (1934).

95. Hall, *Business Giving*, *supra* note 11, at 232-234 (listing corporations that lobbied for tax deductions). For example, Gerard Swope, President of General Electric Company, was a particularly vocal proponent of providing a tax incentive to increase corporate giving. In his classic article "For Whom Are the Corporate Managers Trustees," Professor Dodd quoted Gerard Swope as saying, "[o]rganized industry should take the lead, recognizing its responsibility to its employees, to the public, and to its stockholders . . ." E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1156 (1932). Professor Dodd relied on quotes from Mr. Swope, and his colleague at General Electric, Owen Young, to prove that public opinion demanded that "those who manage our business corporations should concern themselves with the interests of employees, consumers, and the general public, as well as stockholders." *Id.*

96. CLOTFELTER, *supra* note 71, at 171.

97. Hall reported that President Roosevelt ultimately supported the corporate deduction. PETER DOBKIN HALL, *INVENTING THE NONPROFIT SECTOR* 60 (1992) (attributing President Roosevelt's reversal to lobbying by Community Chest officials). The official GOP statement regarding the passage of the corporate contribution deduction included several choice jibes directed at President Roosevelt noting his "dictatorial powers . . . and . . . his individual control of unprecedented sums of money." *Id.*

98. Arthur Schlesinger, Jr., *The 'Hundred Days' of F.D.R.*, N.Y. TIMES, Apr. 10, 1983, §3, at 1 (discussing the enactment of 15 major laws between March and June, 1933).

99. See *infra* note 101 and accompanying text (discussing Congressional reluctance to increase tax rates).

the nature of corporate purpose.<sup>100</sup> Reluctant to increase tax rates, the federal government sought voluntary transfers from the private sector (i.e., nontax revenue) to fund needed social programs.<sup>101</sup> Although the corporate deduction clarified the federal tax treatment of corporate transfers to charity,<sup>102</sup> such transfers remained ultra vires under the laws of many states.<sup>103</sup>

## 2. *The Ever-Changing Theory of Corporate Purpose*

Legislative and judicial resistance to corporate giving underscores the paradox inherent in the term "corporate giving." The notion of a corporation making a "gift" to charity — giving away its assets — may or may not make sense depending upon one's view of the corporation.<sup>104</sup> If the goal of a corporation is to maximize shareholder profit and gain, then a corporate "gift" must advance that end.<sup>105</sup> On the other hand, if a corporation has responsibilities to constituencies beyond its shareholders (or to society at large), then a corporate "gift" must address these responsibilities.<sup>106</sup> While it may be easier to justify a corporate "gift" under the latter more expansive view of corporate purposes, as the proponents of corporate giving illustrate, it is possible to justify a "gift" under the profit maximiza-

100. For a discussion of the Berle-Dodd debate, see *infra* notes 120-52 and accompanying text.

101. For example, the federal government had looked to business to address the growing problem of unemployment. The unemployment insurance system was not implemented until the enactment of the Social Security Act in 1935. MITCHELL, *supra* note 92, at 23 (citing a 1929 Senate Report determining that American business and not the federal government should provide insurance against unemployment).

102. The testimony of advocates for the deduction stressed the need for uniform treatment of corporate transfers to charity. In later years, the lobbyists focused on a 1934 Supreme Court decision which held that only a transfer resulting in a direct benefit to the corporation was deductible as an ordinary and necessary business expense. *Old Mission Cement Co. v. Helvering*, 293 U.S. 289 (1934). See *Proposed, supra* note 77, at 123 (discussing *Old Mission*).

103. See *supra* note 77 (describing legislators' attitudes toward corporate giving).

104. See generally David Millon, *Theories of the Corporation*, 1990 DUKE L. J. 201 (discussing various theories of corporate purpose). This Article focuses only on the goals of the corporation and not its form, thereby intentionally sidestepping the debate as to whether the corporation exists as a separate entity or an aggregate (whether of shareholders or autonomous contracting agents). For purposes of corporate giving, the entity versus aggregate distinction appears irrelevant given that corporate giving can be justified under either conception. The central issue is corporate purpose, even though a theory of corporate purpose is necessarily informed by one's view of the nature of the corporate form.

105. See *infra* notes 120-52 and accompanying text (comparing the profit maximization model of the corporation to the social responsibility model). The practice of "enlightened self-interest" attempts to explain corporate giving in terms of corporate (and hence shareholder) benefit.

106. See *infra* notes 120-52 and accompanying text (comparing the social responsibility model of the corporation to the profit maximization model).

tion model of corporate purpose.<sup>107</sup>

(a) Early conceptions of corporate form and purpose

By the mid-nineteenth century, a corporation was a well-established form of business association.<sup>108</sup> Legal scholars regarded a corporation as an artificial entity created by the state.<sup>109</sup> States closely regulated the ability to incorporate, generally requiring the issuance of a corporate charter by the state legislature, and limiting corporate powers to those expressly granted by the state. Because corporate transfers to charity were not expressly granted by corporate charter or relevant corporate code, they were *ultra vires*. As support for the *ultra vires* nature of corporate transfers to charity, commentators cited Lord Bowen's admonition that "charity has no business sitting at the board of directors, *qua* charity."<sup>110</sup>

The legislative prerogative to grant corporate charters presented the potential for corruption and monopolistic concentration in certain industries.<sup>111</sup> The critics of the charter system advanced the notion of "free incorporation" and urged the passage of comprehensive incorporation statutes.<sup>112</sup> The pervasive enactment of state incorporation codes by the 1870's provided greater access to the corporate form<sup>113</sup> which in turn called into question the artificial entity model

107. See *infra* notes 333-444 and accompanying text (discussing the profit-oriented justifications for corporate giving). Corporate managers agree — social responsibility is good advertising. See *infra* notes 333-91 (discussing corporate giving as advertising).

108. 4 ROSCOE POUND, JURISPRUDENCE 200 (1959) (listing commentators and articles discussing the corporation).

109. See *id.* at 214, 222.

110. *Hutton v. West Cork Railway Co.*, 23 Ch.D. 654 (1883). Karl pointed out that the oft-cited quotation is dicta from a case the facts of which did not involve charitable giving, but rather a proposed payment to the board of directors prior to the dissolution of the company. Karl, *supra* note 74, at 26-27 ("As is sometimes the case in judicial history, however, the words served a wider purpose than the situation to which they had originally been directed. A judicial aside constituting a critical attack on a highly questionable practice became a noble doctrine designed to measure all corporate behavior.").

In fact, a close reading of Lord Justice Bowen's 1883 opinion supports the belief that corporate giving can further the corporate goal of profit maximization: "There is, however, a kind of charitable dealing which is for the interest of those who practise [sic] it, and to that extent and in that garb (I admit not a very philanthropic garb) charity may sit at the board, but for no other purpose." *Hutton*, 23 Ch.D. at 673.

111. Morton J. Horwitz, *Santa Clara Revisited: The Development of Corporate Theory*, 88 W. VA. L. REV. 173, 181 (1985) (stating that "special charters were denounced for their encouragement of legislative bribery, political favoritism, and above all, monopoly").

112. *Id.* (stating that these critics believed "free incorporation" would break the corruption).

113. *Id.*

of the corporation.<sup>114</sup>

In place of the artificial entity model, legal scholars began to conceptualize the corporation as the result of natural market forces bringing together a group of individual property owners. A corporation was viewed as an aggregate of individual property owners — its shareholders/owners. Professor Horwitz reported that this aggregate private property model of the corporation was widely accepted by the last quarter of the nineteenth century.<sup>115</sup>

In 1932, Professors Berle and Means published their study of corporate governance which documented the growing power of corporate managers and the increasing separation of corporate control from ownership.<sup>116</sup> The individual property model described above could not accommodate the emergence of widely-held corporations, institutional investors and the concomitant rise of the managerial class.<sup>117</sup> The Berle and Means study showed that the interests of corporate managers (i.e., the expanding managerial class) did not always coincide with the interests of the corporation/shareholders.<sup>118</sup> Corporate managers had discretion to advance their class-specific goals, potentially at the expense of the interests of the corporation/shareholders.<sup>119</sup>

### (b) Corporate purpose and the Berle-Dodd debate.

Berle later addressed his concern over unfettered managerial discretion in his debate-provoking article entitled *Corporate Powers as Powers in Trust*.<sup>120</sup> Berle believed that the managers of the corporate entity owed a fiduciary responsibility to its shareholders: "through the very nature of the corporate entity, responsibility goes with power."<sup>121</sup> Based upon an application of the law of trusts, Berle

114. *Id.*

115. *Id.* at 182 (stating that the late 1800's corporation laws emphasized "the property rights of shareholders").

116. See BERLE & MEANS, *supra* note 37, at 47-68.

117. *Id.* at 47. An exception to this is a closely-held, shareholder-operated corporations.

118. *Id.*

119. See, e.g., Kenneth B. Davis, Jr., *Discretion of Corporate Management To Do Good at the Expense of Shareholder Gain — A Survey of, and Commentary on, the U.S. Corporate Law*, 13 CANADA-UNITED STATES L. J. 7, 13-15 (1988) (arguing corporate managers can and do make transfers to charity that are at odds with corporate interests); MICHAEL USEEM, *THE INNER CIRCLE: LARGE CORPORATIONS AND THE RISE OF BUSINESS POLITICAL ACTIVITY IN THE U.S. AND U.K.* 125-27 (1984) (citing ability to promote classwide goals through charitable contributions).

120. Adolph A. Berle, Jr., *Corporate Powers As Powers in Trust*, 44 HARV. L. REV. 1049 (1931) [hereinafter Berle, *Corporate Powers*].

121. *Id.*, at 1050; see also Adolph A. Berle, *For Whom Corporate Managers ARE Trustees: A*

proposed the existence of an "equitable limitation" on the exercise of all corporate powers and stated such powers "are necessarily and at all times exercisable only for the ratable benefit of all the shareholders as their interest appears."<sup>122</sup> Under Berle's model of the corporation, the sole purpose of the corporate enterprise was to maximize shareholder profit.<sup>123</sup>

Berle's theory provoked a creative response from Professor Dodd.<sup>124</sup> Dodd did not question Berle's application of fiduciary concepts to the exercise of corporate powers, but he did reject Berle's assertion that "business corporations exist for the sole purpose of making profits for their shareholders."<sup>125</sup> Dodd redefined the fiduciary responsibilities of corporate managers to encompass a social or public component. As authority for his broader view of corporate purpose, Dodd noted that "public opinion, which ultimately makes law . . . view[s] . . . the business corporation as an economic institution which has a social service as well as a profit-making function."<sup>126</sup>

The Berle-Dodd debate as to the proper goal of the corporation continues to the present day.<sup>127</sup> At various times the different camps have each declared victory or conceded defeat.<sup>128</sup> Under Dodd's model of the corporate purpose, transfers to charity are viewed as a necessary means to discharge a corporation's social responsibility. Under Berle's model, transfers to charity are permissible, provided they advance shareholder profit and gain.

### 3. *Theory, Doctrine, and the Courts*

Many commentators have chronicled the cases considering the legitimacy of corporate giving, by noting that a given outcome of a case reflects the acceptance of a particular theory of the corpora-

---

Note (emphasis in original), 45 HARV. L. REV. 1365 (1932) [hereinafter, Berle, *Note*] (stating that "corporate managements are trustees for corporate security holders").

122. Berle, *Corporate Powers*, *supra* note 120, at 1049.

123. *Id.* at 1049-50 (stating that corporate managers have a duty to always act for the benefit of the shareholders).

124. Dodd, *supra* note 95, at 1148.

125. *Id.*

126. *Id.*

127. For a retrospective on the debate, see Joseph L. Weiner, *The Berle-Dodd Dialogue on the Concept of the Corporation*, 64 COLUM. L. REV. 1458 (1964).

128. See, e.g., Berle, *Note*, *supra* note 121, at 1366 (acknowledging that "Professor Dodd's argument is not only sound, but familiar").



tion.<sup>129</sup> Commentators interpret *Dodge v. Ford Motor Company*<sup>130</sup> and *A.P. Smith v. Barlow*,<sup>131</sup> the most often-cited cases on corporate giving, as representing opposing views of corporate purpose.<sup>132</sup> In such commentary, the outcome serves as proof of the ascendancy of the particular theory of the corporation said to be represented by the outcome.

Judicial approval of corporate giving was not the result of widespread acceptance of Dodd's theory of social responsibility.<sup>133</sup> Instead, the courts simply expanded the type of activities or expenditures recognized to enhance shareholder profit and gain to include corporate giving tempered by "enlightened self-interest." This compromise achieves a balance between the Berle and Dodd models without disturbing the premise that profit maximization is the goal of the corporation.

Professors Berle and Dodd, as well as later commentators, cited *Dodge* for the limited proposition that the sole purpose of a corporation is to maximize shareholder profit and gain.<sup>134</sup> In *Dodge*, the Michigan Supreme Court prohibited Henry Ford from instituting

129. See generally Allen, *supra* note 9, at 264; Phillip I. Blumberg, *Corporate Responsibility and the Social Crisis*, 50 B. U. L. REV. 157, 166-92 (1970); Davis, *supra* note 119, at 57; Green, *supra* note 60, at 245; Kenneth J. Yerkes, Note, *Corporate Charitable Contributions: Expanding the Judicial Analysis in a Post-Economic Recovery Act World*, 58 IND. L.J. 161, 165-68 (1982).

130. 170 N.W. 668 (Mich. 1919).

131. 98 A.2d 581 (N.J. 1953).

132. *Dodge* is cited as representing adherence to a profit maximization model of corporate purpose. See *infra* note 134. *A.P. Smith* is cited as representing the acceptance of the social responsibility model of corporate purpose. See *infra* note 150. Although their conclusions regarding the practice of corporate giving differ widely, commentators adopt a generally consistent analysis of the leading cases. Subject to some variations, the commentators, categorize the cases in this area in three loosely defined stages leading to the eventual approval of corporate giving: ultra vires (i.e., giving not permitted), direct benefit (i.e., giving permitted if it provides a direct benefit for the corporation), and indirect or long-term benefit (i.e., giving permitted if it provides an indirect or long-term benefit for the corporation).

133. In addition to *A.P. Smith*, commentators cite *Theodora Holding Corp. v. Henderson* for the proposition that corporations have unfettered power to engage in socially responsible actions. 257 A. 2d 398 (Del. Ch. 1969). *Theodora* involved the unusual situation where a corporation was providing the initial funding for its affiliated charitable corporation. *Id.* at 399. See, e.g., Green, *supra* note 60, at 253 (discussing *Theodora*).

134. Berle, *Corporate Powers*, *supra* note 120, at 1061 n.33; Dodd, *supra* note 95, at 1146 n.3. Later commentators cite *Dodge* as an example of the so-called "direct benefit rule" under which corporate transfers to charity are allowed provided they directly benefitted the corporation. See, e.g., Green, *supra* note 60, at 248-49 (citing *Dodge* for this proposition). Commentators compare *Dodge* to later cases such as *A.P. Smith* which approve corporate transfers to charity where the transfer produces a long-term benefit. *Id.* at 246-502 (comparing *Dodge* to *A.P. Smith*). The doctrinal distinction between a direct benefit and a long-term benefit obscures the fact that the purpose of the corporation remains the same under either rule; the maximization of shareholder profit. The only variable is the type of activities which are considered to maximize profits.

far-reaching social initiatives at the perceived expense of shareholder profit.<sup>135</sup> Henry Ford induced the Board of Directors of Ford Motor Company to suspend further payments of a special dividend in order to increase wages and reduce the price of the automobile.<sup>136</sup> In the prior four years, the special dividend had paid over \$41 million on only \$2 million of capital.

The Dodge brothers, who would later become Ford's competitors,<sup>137</sup> contested the Board action asserting that the corporation owed its first duty to its shareholders, the owners of the corporation. The court ordered the Ford Motor Company to pay the special dividend<sup>138</sup> and it expressly rejected Mr. Ford's vision of the role of the corporation:

There should be no confusion. . . of the duties which Mr. Ford conceives that he and the stockholders owe to the general public and the duties which in law he and his codirectors owe to protesting, minority stockholders. A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to

---

135. Henry Ford's Social Initiatives: Ford's primary goal was to plow the excess assets earmarked for special dividends back into the auto company so that Ford could realize his "ambition": "My ambition," said Mr. Ford, "is to employ still more men; to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes. To do this, we are putting the greatest share of our profits back into the business." Dodge v. Ford Motor Co., 170 N.W. 668, 683 (Mich. 1919) (quoting Mr. Ford). The Court's response to Mr. Ford's declaration was that Ford was taking the role that he knew better than the shareholders how their profits should be reinvested, (i.e. fully plowing back the profits for plant expansion and employee growth). The *Dodge* Court continued:

The record, and especially the testimony of Mr. Ford, convinces that he has to some extent the attitude towards shareholders of one who has dispensed and distributed to them large gains and that they should be content to take what he chooses to give. His testimony creates the impression, also, that he thinks the Ford Motor Company has made too much money, has had too large profits, and that although large profits might be still earned, a sharing of them with the public, by reducing the price of the output of the company, ought to be undertaken.

*Id.* at 683-84.

The Court essentially found Ford's motives far to charitable as compared to how much profit was being earned. *Id.* at 684. The Court held that the special dividend that had previously been distributed when profits were excessive be distributed again (based on federal statutory guidelines). *Id.* at 679.

136. The Board voted to retain \$58 million in profits to finance the reforms. The payment of regular dividends were not effected by the action. *Id.* at 670-73.

137. John and Horace Dodge were born in the 1860s and formed the automobile firm of the Dodge Brothers in 1914. Vern Parker, *Auto Weekend; Out of the Past*, WASH. TIMES, Sept. 13, 1991, at G1.

138. The Michigan Supreme Court distinguished the types of expenditures challenged in *Dodge* from "an incidental humanitarian expenditure of corporate funds for the benefit of the employees, like the building of a hospital for their use and the employment of agencies for the betterment of their condition." *Id.* (quoting *Dodge*, 170 N.W. at 684).

attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits among stockholders in order to devote them to other purposes.<sup>139</sup>

The conflict between Henry Ford's vision of the role of the corporation and the desires of dissenting shareholders for immediate pecuniary gain foreshadowed the debate between Professors Berle and Dodd concerning the purpose of the corporation.<sup>140</sup>

In *A.P. Smith*,<sup>141</sup> the New Jersey Supreme Court upheld the power of a corporation to transfer funds to charity. A shareholder challenged a 1951 Board resolution authorizing the company to transfer \$1,500 to Princeton University.<sup>142</sup> The court interpreted the implied or incidental powers<sup>143</sup> of a corporation in light of changing social and economic conditions and upheld the transfer on both statutory and common law grounds.<sup>144</sup> The court reasoned:

When the wealth of the nation was primarily in the hands of individuals, they discharged their responsibilities as citizens by donating freely for charitable purposes. With the transfer of wealth to corporate hands and the imposition of heavy burdens of individual taxation, they have been unable to keep pace with increased philanthropic needs they have therefore, with justification, turned to corporations to assume the modern obligations of good citizenship in the same manner as humans do.<sup>145</sup>

The court approved the transfer because it produced a benefit for the corporation, albeit somewhat abstract. The New Jersey Supreme Court linked corporate transfers to charity to the preservation of the

139. *Id.*

140. See generally Dodd, *supra* note 95, at 1156.

141. See Green, *supra* note 60, at 249 (stating *A.P. Smith* upheld transfers to charity whose relationship to the corporation was at best uncertain).

142. See Hall, *Business Giving*, *supra* note 11, at 236 (suggesting that *A.P. Smith* was a test case orchestrated by Standard Oil of New Jersey which was anxious to resolve any lingering ultra vires concerns surrounding corporate transfers to charity).

143. "Implied or incidental powers" are used interchangeably. See, e.g., *A. P. Smith, Mfg. Co. v. Barlow*, 98 A.2d 583 (N.J. 1953).

144. *Id.*

145. *Id.* at 585-86. Hall discussed changing social and economic conditions in similar terms and noted the rise of a managerial class without private fortunes of their own. Hall wrote:

This separation of ownership and control led to major changes in business philanthropy. When owner-managers like Carnegie, Vanderbilt, or Pullman diverted corporate assets for charitable purposes, they were accountable to no one because they were, in effect, giving away their own money. Usually modest gifts from their firms were accompanied by generous ones from their private fortunes. . . . And, because they were dealing with other people's money, they were not free to make corporate gifts unless these could be justified on grounds of corporate well-being.

Hall, *Business Giving*, *supra* note 11, at 227-228.

“free enterprise system.”<sup>146</sup>

But even if we confine ourselves to the terms of the common law rule in its application to current conditions, such expenditures may likewise readily be justified as being for the benefit of the corporation; indeed, if need be the matter may be viewed strictly in terms of actual survival of the corporation in a free enterprise system.<sup>147</sup>

*A.P. Smith* represents judicial endorsement of the use of corporate funds to invest in a future environment favorable to the corporation. The court upheld the power of corporations to make transfers to charity in recognition of the fact “that their salvation rests upon a sound economic and social environment which in turn rests in no insignificant part upon free and vigorous nongovernmental institutions of learning.”<sup>148</sup> This is exactly the type of “enlightened self-interest” advocated by corporate managers and fundraisers.<sup>149</sup>

Although commentators cite *A.P. Smith* as adopting Professor Dodd’s model of the socially responsible corporation,<sup>150</sup> the reasoning is much more modest. The court did not embrace a new theory of corporate purpose. It never questioned whether the proper goal of the corporation was to maximize shareholder profit and gain. It simply recognized that corporate transfers to charity can result in an indirect or long-term corporate benefit.<sup>151</sup> The holding advanced a longer view as to what type of activities could benefit the corporation and ultimately, its shareholders — a view that is entirely consistent with “enlightened self-interest.”<sup>152</sup>

146. Throughout the Cold War period, the need to further the capitalist system of private ownership and protect “free enterprise” was a consistent theme in corporate giving. For a discussion of the use of corporate transfers to charity to advance corporate political and economic interests, see *infra* notes 469-87 and accompanying text.

147. *A.P. Smith*, 98 A.2d at 586.

148. *Id.*

149. In fact, the term “enlightened self-interest” is attributed to the testimony of Frank W. Abrams, former Chairman of the Board of Standard Oil of New Jersey, offered in connection with the *A.P. Smith* case. Mr. Abrams remarked: “During the forty years of my business career, I have observed a slow but steady transition in the attitude of corporate management from one of more or less exclusive preoccupation with self-interest, to one of self-interest tempered with a broadening sense of social consciousness.” EELLS, *supra* note 74, at 1 (quoting Abrams).

150. See, e.g., Davis, *supra* note 119, at 63 (characterizing *A.P. Smith* as representing a fourth stage in the development of corporate giving law providing that “the corporation has the power to be altruistic and donate its funds irrespective of any prospect of quid pro quo, just as if it were an individual.”) (citing *Union Pac. R.R. v. Trustees, Inc.*, 329 P.2d 398, 401-02 (Utah 1958)).

151. *A. P. Smith*, 98 A.2d at 585.

152. See *supra* note 149 (discussing the term “enlightened self-interest”).

#### 4. *In Search of the Socially Responsible Corporate Citizen*

The search for a socially responsible corporate citizen will not yield many tangible results. Judicial decisions authorizing corporate transfers to charity simply stretch the prevailing notion of profit-maximization. They do not represent the judicial acceptance of the social responsibility model of corporate purpose.<sup>153</sup> The enlightened self-interest rationale of *A.P. Smith* is shared by corporate managers and fundraisers who assert that corporate giving inures to the long-term benefit of the corporation's shareholders.<sup>154</sup> It also appears in contemporary management theory which merges issues of social responsibility into profit maximization.<sup>155</sup> Only the federal tax code holds fast to the ideal of the socially responsible corporation.<sup>156</sup>

Unlike the court in *A.P. Smith*, Congress seems to have accepted Professor Dodd's new theory of social responsibility with the enactment of the corporate charitable contribution deduction. In testimony before various Congressional committees, supporters of the deduction expanded President Roosevelt's call for assistance from the private sector to include corporate citizens as well as individuals. In 1934, a representative of the Community Chests and Councils of New York noted the need to remove "the barrier against corporate generosity":<sup>157</sup>

Private philanthropy has had a progressively more difficult task to hold up its end of the national charitable responsibility during the depression. It has needed every reinforcement and argument that could be made available. If,

---

153. To the contrary, social responsibility has been derided by law and economic scholars and generally discredited. Allen, *supra* note 9, at 265 ("To law and economics scholars, who have been so influential in academic corporate law, this model [social responsibility] is barely coherent and dangerously wrong.") See, e.g., MILTON FRIEDMAN, CAPITALISM AND FREEDOM 133 (1962) ("Few trends could so thoroughly undermine the very foundation of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their shareholders as possible.").

154. As explained in Part II, this belief continues despite the absence of empirical evidence that corporate giving or other socially responsible behavior actually increases profits. Allen, *supra* note 9, at 273. See also *infra* notes 273-99 and accompanying text.

155. See *infra* notes 273-332 and accompanying text (discussing possible business benefits of being perceived as socially responsible).

156. As discussed in Part I, Section B, the social responsibility model is the basis for the section 170 deduction. The notion of social responsibility arises frequently in Congressional testimony and the legislative history of the corporate charitable deduction. The explanation for this anomaly can be found in the historical context of the enactment of the deduction. See *supra* notes 93-103 and accompanying text.

157. *Hearings, supra* note 77, at 137. This statement is almost identical to one submitted the following year by Frederic R. Kellogg, President of Community Chests and Councils, Inc. of New York. See *Proposed, supra* note 77, at 120.

as the President constantly states, private charity is to persist and carry its share of the load of our less fortunate citizens, its approach to corporations for contributions ought to be eased rather than made more difficult. Instance after instance could be cited of where corporations this last year have withdrawn their contributions with the taxation situation as one of their reasons. Private charity cannot carry on without the help of the corporations to which it has become accustomed.<sup>158</sup>

Thus, the language of the socially responsible corporation provided the justification for the enactment of the deduction and added rhetorical force to the federal government's request for funds.

Curiously, the notion of the socially responsible corporate citizen continued to inform the congressional debate over the 1981 amendments liberalizing the corporate charitable deduction<sup>159</sup> long after the theory had been discredited.<sup>160</sup> For example, Senator Byrd justified the increase in the ceiling limitation imposed on corporate contributions by remarking: "I feel that the corporations of our nation have an obligation . . . to the various charities of our country. . . ."<sup>161</sup> Senator Kennedy expressed similar sentiments and asserted that it was time "the corporations of this country [were involved in] the process of meeting the needs of the people of our society."<sup>162</sup>

Corporate image-makers express a strong belief that strategic corporate giving is good for business.<sup>163</sup> As discussed in detail in Part

---

158. See *Hearings, supra* note 77, at 135 (emphasis added). As authority for his position, Mr. Burns quoted from President Roosevelt's October 15, 1933 broadcast where the President stated: I have spoken on several occasions of the vital importance to our country that private charity in all that broad term covers, must be kept up at least to the levels, and I hope beyond the levels, of former years. At this opening of the Four Week's 1933 Mobilization for Human Needs, I want not only to reaffirm what I have said before, but to stress the fact that the fine teamwork in the recovery program cannot be successful if an important horse is lying back in the traces.

*Id.* Mr. Burns argued that encouraging corporate deductions would serve as "the best concrete evidence that the Administration means to promote private charitable contributions to its utmost."  
*Id.*

159. The 1981 Economic Recovery Act increased the ceiling limitation of the deductibility of corporate charitable contributions from 5% to 10% of the corporation's taxable income. I.R.C. § 170(b) (1988). See *infra* notes 186-87 and accompanying text (discussing the 10% limitation).

160. One possible explanation is that the federal government continues to find utility in the moral persuasion implicit in appeals based on social responsibility. From the standpoint of the corporation, there is no cause to complain because public opinion surveys indicate a favorable reaction to perceived acts of social responsibility. See *infra* notes 301-308 and accompanying text (discussing marketing and fundraising literature which supports the notion that social responsibility improves public opinion).

161. 127 CONG. REC. S8353. (July 24, 1981) (statement Sen. Byrd).

162. *Id.* S5352 (statement Sen. Kennedy).

163. Corporate marketing executives strongly reject the notion of corporate altruism, implying

II, contemporary corporate giving can be viewed in three different categories: (i) advertising and marketing, (ii) public relations, and (iii) investment in future markets and future employees.<sup>164</sup> Corporate transfers that represent advertising or marketing expenditures are designed to provide the most immediate impact. Such expenditures satisfy the goal of profit maximization as would any advertising or marketing expenditures. The difference is that such transfers are paid to a qualified charity rather than an advertising agency.<sup>165</sup>

Even Milton Friedman, a vocal opponent of corporate giving,<sup>166</sup> recognized that at times corporate giving can further the goal of maximizing corporate profits and shareholder gain. He remarked:

Charitable activity in some cases may contribute to a corporation's making as much money as possible. It may be that an enterprise that needs goodwill of the community, that it wants to have its workers motivated to regard the enterprise as one that's worth sacrificing for, worth working hard for, and so on, may find that the most effective way to promote that kind of an environment is to provide charitable assistance in its local community.<sup>167</sup>

Continuing in this vein, several corporate giving texts attempt to appeal to the profit maximizer in us all, by invoking Adam Smith. They quote with approval the following missive from *The Wealth of Nations*:<sup>168</sup>

---

that such behavior would be irresponsible to the shareholders. Koch quoted Irving Kristol, then resident scholar at the American Enterprise Institute, who explained:

Some corporate executives seem to think that their corporate philanthropy is a form of benevolent charity. It is not. . . . Charity involves dispensing your own money, not your stockholders. When you give away your own money, you can be as foolish, as arbitrary, as whimsical as you like. But when you give away your stockholders' money, your philanthropy must serve the longer-term interest of the corporation. Corporate philanthropy should not be, cannot be disinterested.

FRANK KOCH, *THE NEW CORPORATE PHILANTHROPY: HOW SOCIETY AND BUSINESS CAN PROFIT* 129 (1979).

164. See *infra* notes 333-444 and accompanying text.

165. Because of the "halo effect," corporate advertising and marketing transfers to charity can produce benefits far in excess of the original transfer. David A. Haimen, Note, *Corporate Sponsorships of Charity Events and the Unrelated Business Income Tax: Will Congress or the Courts Block the IRS Rush to Sack the College Football Games?* 67 NOTRE DAME L. REV. 1079, 1090 (1992). For example, "John Hancock Life Insurance Company estimated that it received \$5.1 million of advertising services in exchange for its 1990 payment of \$1.6 million to associate its name with [a college bowl] game." *Id.* at 1090 n.59. The tax-exempt character of the transfer in the hands of the donee charity also enhances the return. *Id.* at 1112-13.

166. See *infra* notes 260-62 and accompanying text (discussing Milton Friedman's views on corporate giving).

167. Willa Johnson, *Freedom and Philanthropy: An Interview with Milton Friedman*, *BUS. & SOC'Y REV.*, Spring, 1989, at 11, 14. Actually, this sentiment is very similar to the view expressed by Lord Bowen. See *supra* note 110 (discussing Lord Bowen's views on corporate giving).

168. See, e.g., ROBERT L. PAYTON, *PHILANTHROPY: VOLUNTARY ACTION FOR THE PUBLIC*

By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good. It is an affectation, indeed, not very common among merchants, and very few words need be employed in dissuading them from it.<sup>169</sup>

Corporate managers and fundraisers freely acknowledge that “[a] corporation can’t perform a charitable act any more than it can fall in love.”<sup>170</sup> They embrace social responsibility only to the extent that it reinforces the corporate bottom line and enhances the “halo effect.”<sup>171</sup> Thus, advocates of corporate giving successfully avoid much of the criticism leveled at the theory of corporate social responsibility<sup>172</sup> because they define such socially responsible behavior as essential to corporate performance.<sup>173</sup>

Recent developments in management theory also take into account the perceived interrelation between corporate economic performance and social responsibility. The result is an integration of “the entire range of business responsibilities . . . : economic, legal, ethical, and philanthropic.”<sup>174</sup> This integrated model does not question the goal of profit maximization.<sup>175</sup> Instead, it expands the types

GOOD, 86 (1988) (quoting the Adam Smith work).

169. ADAM SMITH, *AN INQUIRY INTO THE NATURE AND CAUSE OF THE WEALTH OF NATIONS*, 456 (R. Campbell & A. Skinner eds., Oxford Univ. Press 1976) (1776). The quoted language is preceded by the famous passage describing the “invisible hand” of the marketplace. *Id.*

170. The quote continues: “[b]ut sometimes when corporations invest in charity — the way they invest, say, in advertising or a new fleet of truck — the dividends can be immense.” KOCH, *supra* note 163, at 5.

171. See *infra* notes 319-32 and accompanying text (discussing the “halo effect”).

172. The criticism of social responsibility comes not only from the profit-maximizers. Useem argued that social responsibility represents an exercise in “classwide politics.” Useem asserted the consequences are evident in the area of “corporate responsibility” — whether manifest in philanthropic giving, advertising, or political subvention. All such programs help shape national political culture, and all are partly the result of classwide not corporate considerations. USEEM, *supra* note 119, at 16.

173. This reasoning allows the advocates to agree wholeheartedly with Professor Lashbrooke, an opponent of corporate giving. Professor Lashbrooke argued, and corporate managers and fundraisers agree that: “Corporate social responsibility does not alter the goal of profit maximization. Corporations have no affirmative duty to be charitable.” Lashbrooke, *supra* note 9, at 241 (asserting that corporate giving fails “[b]ecause a corporation is a nonhuman, artificial entity, it can not have integrity and, hence, can not be held morally responsible as a citizen”). Professor Lashbrooke continued “corporate social responsibility should be limited to the moral minimum: to do no unnecessary harm while making a profit.” *Id.* at 242.

174. Archie B. Carroll, *The Pyramid of Corporate Social Responsibility: Toward the Moral Management of Organizational Stakeholders*, BUS. HORIZONS, July-Aug. 1991, at 39, 40.

175. Carroll stressed that “[a]ll other business responsibilities are predicated upon the economic responsibility of the firm, because without it others become moot considerations.” *Id.* at 41. Carroll continued:

The traditionalist might see this as a conflict between a firm’s “concern for profits”



of behavior which enhance profit maximization and recognizes that stakeholder responsibility, as well as a more gradual view of social responsibility, are essential elements for corporate success.<sup>176</sup>

*C. The Structure of the Federal Income Tax Corporate Charitable Contribution Deduction, Its Interpretation, And Its Limitations*

Charitable giving is fueled and encouraged by the federal income tax charitable contribution deduction allowed under section 170 for both individuals and corporations. The charitable deduction reduces the cost of giving, thereby increasing the amount that a donor can transfer to a qualified charity. In the case of a corporation which makes a deductible transfer of  $\$100x$ <sup>177</sup> to a qualified charity, the deduction reduces the corporation's taxable income by  $\$100x$ .<sup>178</sup> This reduction in taxable income produces a corresponding decrease in the corporation's tax liability equal to the amount of the deduction multiplied by the corporation's top marginal income tax rate. In 1993, the current top marginal corporate tax rate was 35%.<sup>179</sup> Thus, a transfer of  $\$100x$  deductible in full in 1993 produces a tax savings of  $\$100x(35\%)$  or  $\$35x$ . The after-tax cost of the transfer (i.e., the amount of the transfer reduced by the tax savings generated by the deduction) is  $\$65x$  (i.e.,  $\$100x$  [deductible transfer] less  $\$35x$  [tax savings]).<sup>180</sup>

---

versus its "concern for society," but it is suggested here that this is an oversimplification. A [corporate social responsibility] or stakeholder perspective would recognize these tensions as organizational realities, but focus on the total pyramid as a unified whole and how the firm might engage in decisions, actions, and programs that simultaneously fulfill all its component parts.

*Id.* at 42-43.

176. *Id.* Carroll concluded:

In summary, the total corporate social responsibility of business entails the simultaneous fulfillment of the firm's economic, legal, ethical, and philanthropic responsibilities. Stated in more pragmatic and managerial terms, the [socially responsible firm] should strive to make a profit, obey the law, be ethical, and be a good corporate citizen.

*Id.* at 43.

177. This assumes that the corporation transfers cash to a qualified charity. Special rules apply to the deductibility of transfers of property. See *infra* note 183 (discussing charitable transfers of property).

178. This further assumes that the corporation is able to "use" the entire amount of the deduction in the year of the transfer. See *infra* notes 186-87 and accompanying text (explaining "ceiling" limitation imposed on corporate charitable contributions).

179. I.R.C. § 11 (1988).

180.  $T$  = deductible transfer,  $r$  = top marginal tax rate. Tax savings equals  $T(r)$ . After-tax cost of deductible transfer equals  $T - (T(r))$ .

The qualified organization receives \$100x, but the after-tax cost to the corporation is only \$65. The “missing” \$35x (i.e., the tax savings generated under section 170) constitutes a tax expenditure — an indirect funding process by which the federal government encourages certain social or economic behavior through the use of tax subsidies.<sup>181</sup>

### 1. Section 170: The Statute

Section 170(a) allows a deduction for certain transfers “to or for the use of” organizations and entities described in section 170(c).<sup>182</sup> The section 170 deduction is available to both individuals and corporations, although individuals and corporations calculate the amount of the deduction differently.<sup>183</sup> In order to qualify as a de-

---

181. The tax expenditure theory was proposed by Professor Surrey and gained wide-spread acceptance by the early 1970s. STANLEY S. SURREY, *PATHWAYS TO TAX REFORM* (1973); STANLEY S. SURREY AND PAUL R. MCDANIEL, *TAX EXPENDITURES 1-31* (1984). Professor Zelinsky wrote:

Few academic doctrines can claim the intellectual and political success of tax expenditure analysis. In roughly a generation's time, Professor Surrey's procedural and substantive critique of tax subsidies has become entrenched in the law school curriculum and in legal scholarship. More impressively, the tax expenditure concept has been enshrined in federal law and become part of the daily discourse of the national budget process.

Edward A. Zelinsky, *James Madison and Public Choice at Gucci Gulch: A Procedural Defense of Tax Expenditures and Tax Institutions*, 102 *YALE L. J.* 1165, 1165 (1993).

As explained in Part III, the tax expenditure theory is by no means without its critics. See *infra* notes 488-522 and accompanying text (discussing tax expenditure theory).

182. Section 170(a)(1) provides: “There shall be allowed as a deduction any *charitable contribution* (as defined in subsection (c)) payment of which is made within the taxable year. A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary.” I.R.C. § 170(a)(1) (1988)(emphasis added). IRC § 170(c) defines the term “charitable contribution.” For the text of IRC § 170(c), see *infra* note 184.

183. I.R.C. § 170(b)(2) (1988). A corporation is entitled to deduct charitable contributions to the extent that such contributions for a given taxable year do not exceed 10% of the corporation's taxable income, computed without regard to any net operating loss or capital loss carryback. Furthermore, a corporation may carryover any unused portion of total deductible contributions for five years. *Id.* § 170(d)(2)(A).

The rules governing the deductibility ceilings for individuals are much more complicated and vary depending upon the type of property transferred and the type of donee organization. See *id.* § 170(b)(1). In general, an individual is entitled to deduct cash charitable contributions to the extent that such contributions to ‘public charities’ for a given taxable year do not exceed 50% of the taxpayer's adjusted gross income (computed without regard to any net operating loss carryback). *Id.* § 170(b)(1). See *supra* note 61 (explaining the distinction between public charities and private foundations). Contributions of long-term gain capital property are deductible only to the extent of 30% of the taxpayer's contribution base. I.R.C. § 170(b)(1)(C) (1988). The taxpayer, however, is entitled to deduct the full fair market value of the property as of the date of the transfer and does not realize any gain on account of the transfer. *Id.* § 170(e)(1)(A). Additional ceiling limitations apply to various transfers to private foundations. See *id.* § 170(b)(1)(C). Indi-

ductible contribution, both the nature of the transfer and the donee must satisfy the statutory requirements. Not only must the transfer be "to or for the use of" a qualified organization, but the transfer must constitute a "charitable contribution," defined as "contribution or gift."<sup>184</sup> The determination of whether the transfer qualifies as a "contribution or gift" is at the heart of the corporate giving paradox. The treasury regulations provide that a contribution must be made with no "reasonable expectation of financial return commensurate with the amount of the transfer. . . ."<sup>185</sup> Yet, as explained in Part II, corporations do not transfer assets to charity without the expectation of receiving something in return.

Section 170(b) limits a corporation's aggregate charitable contributions to 10% of the corporation's taxable income, computed without regard to the contribution deduction, any net operating loss carryback, or capital loss carryback.<sup>186</sup> To the extent that a corporation's otherwise deductible contributions exceed the 10% limit, the corporation may carryover such excess amounts for up to five years.<sup>187</sup>

---

viduals may carryover any unused portion of total deductible contributions for five years, subject to the applicable ceiling limitations. *Id.* § 170(d)(1)(A).

184. *Id.* § 170(c). Section 170(c) provides, in pertinent part:

Charitable Contribution Defined.— For purposes of this section, the term "charitable contribution" means a contribution or gift to or for the use of —

(2) A corporation, trust, or community chest, fund, or foundation —

(A) created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States;

(B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals;

(C) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and

(D) which is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

*Id.*

185. Treas. Reg. § 1.170A-1(c)(5) (as amended in 1990). The focus of this Article is the "contribution or gift" requirement and it does not explore in any detail what constitutes a transfer "to or for the use of" a qualified donee or what types of entities are qualified to receive tax-deductible contributions. *See infra* notes 508-11 and accompanying text (discussing the tax exemption for charitable organizations).

186. I.R.C. § 170(b)(2) (1988).

187. *Id.* 170(d)(2). The 10% limit assumes that some corporate giving approaches and indeed exceeds the ceiling amount.

## 2. The "Contribution or Gift" Requirement

In order to qualify as a charitable contribution deductible under section 170, a transfer must be a "contribution or gift."<sup>188</sup> The contribution or gift requirement ensures that not every transfer to a qualified charity is deductible. It also illustrates that the tax code purports to distinguish between interested and disinterested corporate transfers. Without the "contribution or gift" requirement, receipt would determine deductibility.<sup>189</sup> This could produce absurd results given that many qualified donees provide services on a fee basis. It would permit taxpayers to convert otherwise nondeductible expenses into charitable contributions.<sup>190</sup> For example, a law student who attends an educational institution that qualifies under section 170(c) would be entitled to deduct the amount of the tuition. The same would be true for the patient who pays his bill to a qualifying hospital, or the music-lover who purchases season tickets for certain orchestras. The courts and the IRS have consistently held that such transfers do not represent deductible charitable contributions,<sup>191</sup> except to the extent that the taxpayer transfers more than the fair market value of the benefit received.<sup>192</sup>

---

188. The transfer must also be to or for the use of a qualified donee organization. As discussed above, this Article focuses on the "contribution or gift" or requirement. The "to or for the use of" requirement asks whether the transfer was complete and whether the donor/taxpayer retains any dispositive control over the property transferred. In addition, the statutorily prescribed parameters of qualified charitable donees raises certain fundamental issues about the social construction of charity that extend far beyond the scope of this Article.

189. The Supreme Court, in *Hernandez v. Commissioner*, specifically rejected this destination of funds argument with regard to religious institutions. 490 U.S. 680 (1989).

190. The ability of a corporation to substitute a section 162 deduction mitigates this concern in connection with corporate taxpayers. Individual taxpayers may not be able to classify as many transfers as ordinary and necessary business expenses. Moreover, individuals are subject to various limitations with respect to section 162 deduction that make the deduction less valuable.

191. *Channing v. United States*, 4 F. Supp. 33, 34 (D. Mass. 1933), *aff'd per curiam*, 67 F.2d 986 (1st Cir. 1933), *cert denied*, 291 U.S. 686 (1934). This doctrine has been extended to include instances where taxpayers attempt to characterize otherwise non-deductible payments as voluntary "contributions." *See, e.g., Winters v. Commissioner*, 468 F.2d 778, 780-81 (2d Cir. 1972) (holding a transfer to a church which funded school attended by taxpayers' children was a non-deductible tuition payment even though taxpayers were not expressly required to pay anything); Rev. Rul. 83-104, 1983-2 C.B. 46 (providing test to determine "[w]hether a transfer of money by a parent to an organization that operates a school is a [deductible] voluntary transfer.").

192. The classic example of a transfer to charity that is part purchase and part gift is the purchase of a ticket to a "rubber chicken" fundraising dinner. If the ticket cost is \$100, the donor can only deduct as a charitable contribution the extent to which the purchase price exceeds the fair market value of the dinner. The actual cost of the dinner to the charity is irrelevant, as is whether or not the donor actually attends the dinner. *See, e.g., Rev. Rul. 67-246*, 1967-2 C.B. 104 (explaining deductibility of a ticket to a charity ball).

In practice, the IRS and the courts rarely challenge corporate transfers to charity except in the most obvious quid pro quo exchanges.<sup>193</sup> Although the courts and the IRS have consistently disallowed blatant quid pro quo transfers, they have based the disallowance on differing interpretations of the "contribution or gift" requirement. Some courts focused on the "subjective" intent of the donor. Others adopted a supposedly "objective" quid pro quo standard, examining what a the donor expected in return for the transfer. Two recent Supreme Court cases resolve the differing judicial conceptions of the "contribution or gift" requirement.<sup>194</sup> Read together, *United States v. American Bar Endowment*<sup>195</sup> and *Hernandez v. Commissioner*,<sup>196</sup> adopt a quid pro quo standard, recognize the "dual-payment" character of certain transfers, and extend the notion of a return benefit to include intangible benefits of a spiritual or religious nature.<sup>197</sup>

---

193. See, e.g., *Dockery v. Commissioner*, 37 T.C.M. (CCH) 317, 321 (1978) (holding that construction of a waterline connecting petitioners with a city's water system as required by local ordinance was not a charitable deduction).

194. *Hernandez v. Commissioner*, 490 U.S. 680, 683 (1989); *United States v. American Bar Endowment*, 477 U.S. 105, 115 (1986). But see MICHAEL J. GRAETZ, *FEDERAL INCOME TAXATION: PRINCIPLES AND POLICIES* 483 (2d ed., 1989) (stating that "[t]he Supreme Court applied the *Duberstein* standard in *United States v. American Bar Endowment*"). Presumably, one could argue that the existence of a quid pro quo shows that the donor did not make the transfer with the requisite "detached and disinterested generosity."

195. 477 U.S. 105 (1986). *American Bar Endowment* held taxpayers who paid insurance premiums were only entitled to claim a charitable deduction for the excess of the amount paid over the fair market value of the insurance. *Id.* at 117 (citing Rev. Rul. 67-246, 1967-2 C.B. 104, 105). The Court further stated that the excess must be paid with donative intent. *Id.* This second requirement can be interpreted as incorporating a *Duberstein*-type test or perhaps it is simply designed to exclude the bad bargain.

196. 490 U.S. 680 (1989).

197. A subjective approach asked "*Why* do donors make transfers to charity?" This question missed the point because it presupposed that the transfer was a gift. The relevant question is whether the donor made a gift at all. Under the *Duberstein* standard the existence of a 'gift' is determined by the donor's intent. The quid pro quo standard determines whether a gift was made by asking "*What* do donors *get* when they make transfers to charity?" or, perhaps more accurately, "*What* do donors *expect to get* when they make transfers to charity?" See *Commissioner v. Duberstein*, 363 U.S. 278, 286-92 (1960) (stating that the parties' expectations regarding the tax treatment of their conduct has nothing to do with whether a transfer is a gift). This further refinement recognizes that actual receipt of a benefit by the donor is not required. See *Singer Co. v. United States*, 449 F.2d 413, 423 (Ct. Cl. 1971) (stating that if the transferor merely expects to receive a substantial benefit from his transfer, this is sufficient to make the transfer nondeductible under section 170). Ironically, the focus on the donor's expectation reintroduces an element of subjective intent.

## (a) The subjective standard

The "subjective" standard provided that a donor must transfer property with "detached and disinterested generosity" in order for the transfer to qualify as a "contribution or gift."<sup>198</sup> Until recently, many courts interpreted the statutory term "contribution" as synonymous with "gift"<sup>199</sup> and applied the *Duberstein*<sup>200</sup> "detached and disinterested" standard to exclude a "gift" from a donee's gross income under section 102.<sup>201</sup> The *Duberstein* standard, as applied to individuals, instructed the factfinder to determine the subjective intent of the donor by reviewing the objective facts of the transfer.<sup>202</sup> A transfer was excluded as a gift only where it was the expression by the donor of "feelings of detached and disinterested generosity out of affection, respect, admiration, charity or like impulses."<sup>203</sup> The factfinder was not bound by the donor's characterization of his or her intent, but instead he or she was directed to make an "objective inquiry as to whether what is called a gift amounts to it in reality."<sup>204</sup> Thus, a court had to examine the "objective" facts of each case in order to determine the donor's "subjective" intent.<sup>205</sup>

---

198. *DeJong v. Commissioner*, 309 F.2d 373, 379 (9th Cir. 1962) (holding taxpayer's transfer to a church which ran religious school attended by taxpayer's children only deductible to the extent that the amount of the transfer exceeded the fair market value of their tuition). In *DeJong*, the Ninth Circuit held that the "contribution or gift" requirement of section 170 was consistent with the interpretation of "gift" for purposes of the exclusion from gross income of "gifts" under section 102. *Id.* It expressly adopted the "detached and disinterested generosity" test enunciated two years earlier in the section 102 context by the Supreme Court in *Duberstein. Id.*; see *Duberstein*, 363 U.S. at 285. In *Duberstein*, the Court interpreted the term "gift" under the predecessor of section 102 (section 23(b)(3) of the Internal Revenue Code of 1939) exclusion of gifts from the donee's gross income. *Duberstein*, 363 U.S. at 280 n.1.

199. "The term 'charitable contribution' as used in § 170 has been held synonymous with 'gift'." GRAETZ, *supra* note 194, at 480.

200. 363 U.S. 278 (1960). "The notion that a deductible charitable contribution must meet the *Duberstein* test for what constitutes a gift has been increasingly supported by the courts." GRAETZ, *supra* note 194, at 482.

201. A criticism of the application of the *Duberstein* standard to the charitable contribution deduction is that, taken out of the section 102 context, it was too narrow. Although a restrictive standard is appropriate for an exclusion from gross income, it is not appropriate for a policy-based deduction from gross income designed to encourage certain socially-desirable behavior. For further discussion of the *Duberstein* standard, see *infra* note 208.

202. *Duberstein*, 363 U.S. at 286 (stating that "the donor's characterization of [the purported gift] is not determinative — that there must be an objective inquiry as to whether what is called a gift amounts to it in reality").

203. *Id.* at 285 (citations omitted).

204. *Id.* at 286.

205. To further obscure the task at hand, the Court stated: "Decision of the issue in these cases must be based ultimately on the application of the fact-finding tribunal's experience with the mainsprings of human conduct to the totality of the facts of each case." *Id.* at 289.

Although followed in some circuits,<sup>206</sup> the application of the *Duberstein* standard to charitable contributions met with varied and sustained criticism, because it was vague,<sup>207</sup> too narrow for a policy-driven deduction,<sup>208</sup> and inapplicable to a corporate donor.<sup>209</sup> Eventually, the IRS abandoned the application of the *Duberstein* standard in the case of a charitable deduction.<sup>210</sup>

As an alternative to the "detached and disinterested" standard, some courts ignored the taxpayer's subjective intent and applied a variation of a quid pro quo test.<sup>211</sup> This test used the language in the

206. *Dowell v. United States*, 553 F.2d 1233, 1238 (10th Cir. 1977); *Winters v. Commissioner*, 468 F.2d 778, 780 (2d Cir. 1972).

207. In *Crosby Valve & Gage Co. v. Commissioner*, 380 F.2d 146 (1st Cir. 1967), *cert denied*, 389 U.S. 976 (1967), the First Circuit lamented:

Were the deductibility of a contribution under section 170(c) of the Internal Revenue Code of 1954 to depend on "detached and disinterested generosity," an important area of tax law would become a mare's nest of uncertainty woven of judicial value judgements irrelevant to eleemosynary reality. . . . If the policy . . . favoring charitable contributions is to be effectively carried out, there is good reason to avoid unnecessary intrusions of subjective judgements as to what prompts the financial support of the organized but non-governmental good works of society.

*Id.* at 146-47.

208. The *Duberstein* standard was developed in the context of a section providing an exclusion from gross income. Traditional canons of construction provide that such provision should be narrowly construed. See *Helvering v. Northwest Steel Rolling Mills, Inc.*, 311 U.S. 46, 49 (1940) ("It has been said many times that provisions granting special tax exemptions are to be strictly construed."). To the contrary, the charitable contribution deduction represents a public policy decision to promote gifts to charity and it should not be narrowly construed. See *Helvering v. Bliss*, 293 U.S. 144, 150-51 (1934) (stating that tax provisions allowing an exemption for income devoted to charity were motivated by public policy concerns, and should not be narrowly construed); see also *Yerkes*, *supra* note 129, at 179 (criticizing *Duberstein* for its "overwhelming concern about the subjective intent of the corporation at the moment of transfer").

209. In *United States v. Transamerica*, 392 F.2d 522 (9th Cir. 1968), the same circuit that decided *Dejong*, held that the *Duberstein* test was inapplicable to corporate donors thereby limiting the holding in *Dejong* to individual donors. *Id.* at 524. The court reasoned, "[i]t does not seem appropriate . . . to demand of a corporate entity such impulses as affection, respect or admiration." *Id.* Recognizing the logical (or illogical) conclusion of such an application, the court mused, "[f]urther, an absolute requirement of detached and disinterested generosity or lack of any business purpose would tend to render *ultra vires* substantially all charitable contributions and thus frustrate congressional intent that corporations should enjoy such deductions." *Id.*

210. Gen. Couns. Mem. 34863 (April 28, 1972) (stating that the IRS should no longer use the *Duberstein* standard in "rulings or litigation involving the deduction of charitable contributions").

211. *Sedam v. United States*, 518 F.2d 242 (7th Cir. 1975) ("[A] payment is not a contribution or a gift under section 170 if it is made with the expectation of receiving a commensurate benefit in return . . ."); *Oppewal v. Commissioner*, 468 F. 2d 1000, 1002 (1st Cir. 1972) ("The more fundamental objective test is . . . [was the payment], to any substantial extent, offset by the cost of services rendered to taxpayers in the nature of tuition?"); *Crosby Valve*, 380 F.2d at 149 (disallowing a tax-free distribution of earnings to the sole shareholder); *Singer Co. v. United States*, 449 F. 2d 413 (Ct. Cl. 1971) (stating that if the donor receives or expects to receive substantial benefits, then he has received "a quid pro quo sufficient to remove the transfer from the realm of deductibility under section 170").

regulations under section 170 to help determine when a transfer is properly characterized as a business expense rather than a charitable contribution.<sup>212</sup> According to the regulations, a transfer is not a contribution if the donor had “a reasonable expectation of financial return commensurate with the amount of the transfer. . . .”<sup>213</sup>

(b) *Hernandez* and the quid pro quo standard

The notion of applying the “detached and disinterested generosity” test to a corporation is intriguing, but the prior practice of the IRS and the *Hernandez*<sup>214</sup> decision render such an inquiry moot, at least for purposes of section 170. In *Hernandez*, the Court disallowed the deduction of amounts paid to the Church of Scientology for religious “auditing” sessions essential to the practice of the taxpayer’s religious belief.<sup>215</sup> The Court focused on the benefits received in exchange for the taxpayer’s transfer. Contrary to longstanding IRS administrative practice,<sup>216</sup> the Court refused to draw a distinction between financial or economic benefits and intangible religious benefits.<sup>217</sup> This disregarded the language in both the regulations and the legislative history that requires the commensurate benefit to be *financial*.

---

212. The irony is that this new external test requires the court to determine the donor’s expectations as shown by the facts and circumstances. The quid pro quo standard merely limited the scope of the *Duberstein* subjective inquiry. One way to show the absence of “detached and disinterested generosity” is to prove the expectation of a commensurate benefit in return. The absence of such an expectation may not be sufficient to meet the *Duberstein* standard, but it would support a finding of detached and disinterested generosity.

213. Treas. Reg. § 1.170A-1(c)(5) (as amended in 1990).

214. 490 U.S. 680 (1989) (Marshall, J., writing for Justices Rehnquist, White, Blackmun, and Stevens). Justices O’Connor and Scalia dissented. *Id.* at 704. Justices Brennan and Kennedy took no part in the decision. *Id.* at 703.

215. *Id.* at 683-84. *Hernandez* represents a chapter in the on-going feud between the IRS and the Church of Scientology. For purposes of the *Hernandez* litigation, the IRS stipulated that the Church of Scientology was qualified to receive tax-deductible contributions under section 170. *Id.* at 686. For a summary of the controversy, see Carol A. Jones, Note, *Hernandez v. Commissioner: the Supreme Court Forces a Square Peg in a Round Hole*, 25 WAKE FOREST L. REV. 917 (1990).

216. As a matter of administrative practice, the IRS did not reduce the amount of a charitable deduction for the value of any religious benefits received in exchange for the transfer. Rev. Rul. 70-47, 1970-1 C.B. 49 (ruling that the cost of pew rentals, building assessments and tithing fully deductible as a charitable contribution). Justice O’Connor’s dissent in *Hernandez* was highly critical of this break with practice and listed numerous payments to religious organizations that would fall under the scope of the majority’s decision (e.g., pew rentals, high holiday tickets, torah readings). *Hernandez*, 490 U.S. at 709.

217. The taxpayer argued strenuously that quid pro quo analysis applied only in the case of economic benefits and that it should not apply to intangible religious benefits, like those the taxpayer received as a result of the “auditing” sessions. *Hernandez*, 490 U.S. at 692.



Under this rule, a donor (individual or corporate) would be required to reduce the deductible value of any transfer to charity to the extent the donor expects to receive even an intangible, nonfinancial, benefit in return. Thus, the goodwill a corporate donor expects in return for a \$100x corporate contribution should prohibit the deductibility of the transfer to the extent of the value of the goodwill.<sup>218</sup>

Since *Hernandez*, the courts and the IRS have refused to characterize corporate transfers to charity as deductible contributions where the corporate donor received an obvious benefit. The benefits identified to date include: relief of maintenance costs,<sup>219</sup> goodwill advertising,<sup>220</sup> increased market share,<sup>221</sup> and necessary compliance with state enabling legislation.<sup>222</sup> Generally, the disallowance of the deduction under section 170 did not disadvantage the corporate tax-

---

218. See *supra* note 192 (discussing the computation of the deduction in the case of transfers to charity that are part gift and part purchase).

219. *Transamerica Corp. v. United States*, 902 F. 2d 1540 (D.C. Cir. 1990). In *Transamerica*, the corporate donor sought to deduct over \$10 million under section 170 for the transfer of certain rights to "original film negatives of motion pictures on nitrate-based film" to the Library of Congress. *Id.* at 1541. Under the terms of the transfer, the corporate donor reserved certain exclusive rights of access to the film for commercial purposes and the Library of Congress agreed to undertake the expensive preservation of the film. *Id.* at 1542. The federal circuit held that *Transamerica* received substantial benefits in return because it reserved access to the preserved negatives and it was relieved of the cost of storage. *Id.* at 1543. *Transamerica* is consistent with a pre-*Hernandez* line of cases involving the transfer of land or facilities to municipal authorities. See, e.g., *Ottawa Silica Co. v. United States*, 699 F.2d 1124, 1125 (D.C. Cir. 1983) (disallowing a deduction for the transfer of real estate to a school district not deductible as a charitable contribution because the corporate donor's surrounding land would increase in value).

220. Priv. Ltr. Rul. 9309006 (November 17, 1992). In PLR 9309006, a supermarket chain intended to set aside 1% of its sales each year for charitable contributions "as part of a promotion and advertising program" and desired to deduct the expenses as an ordinary and necessary business expense under section 162. The ruling allowed the deduction finding that "the promotion is a form of goodwill advertising which keeps the taxpayer's name before the public." *Id.*; see also Rev. Rul. 63-73, 1963-1 C.B. 44 (permitting a deduction under section 162(a) where the donor corporation identified the charitable donee in its advertising campaign); accord Priv. Ltr. Rul. 8515014 (January 7, 1985); Priv. Ltr. Rul. 7843062 (July 27, 1978).

221. Priv. Ltr. Rul. 9045015 (August 9, 1990) (concluding corporate transfers to charity "reasonably calculated to maintain and improve [donor's] current business . . . as well as enlarge the market.") This ruling is consistent with *Singer Co. v. United States*, 449 F.2d 413 (Ct. Cl. 1971) where the court held that "enlarging the future potential market by developing prospective purchasers of home sewing machines and more particularly, Singer machines," was a "reasonable" expectation of financial return. *Id.* at 423. See also, Rev. Rul. 72-314, 1972-1 C.B. 44 (ruling that it was reasonable to expect a transfer to a charity organized to promote community development in the neighborhood where taxpayer's brokerage business was located to increase business).

222. Priv. Ltr. Rul. 9011026 (December 18, 1989) (ruling that the payment of net earnings subject to certain exceptions, by the operator of a racing facility required by state law are deductible as ordinary and necessary business expenses). See also Rev. Rul. 77-124, 1977-1 C.B. 39.

payer because disallowance, in most cases,<sup>223</sup> insured its deductibility under section 162.<sup>224</sup>

### 3. *Intersection With the Section 162 Deduction for Ordinary and Necessary Business Expenses*

If a corporate transfer to a qualified charity does not constitute a contribution or gift under section 170, it may be an ordinary and necessary business expense deductible under section 162.<sup>225</sup> The section 170 regulations provide:

Transfers of property to an organization described in section 170(c) which bear a direct relationship to the taxpayer's trade or business and which are made with a reasonable expectation of financial return commensurate with the amount of the transfer may constitute allowable deductions as trade or business expenses rather than as charitable contributions. See section 162 and the regulations thereunder.<sup>226</sup>

Section 162(b)<sup>227</sup> specifically prohibits the use of section 162 to circumvent the ceiling limitations imposed under section 170.<sup>228</sup> The acknowledged overlap of section 170 and section 162 highlights the tax code's conviction that it can distinguish a corporate contribution to charity (i.e., a charitable purchase of advertising or goodwill) from a business expense (i.e., a commercial purchase of advertising or goodwill).<sup>229</sup>

---

223. In *Transamerica*, the Court of Claims disallowed a charitable deduction because it found a quid pro quo exchange. *Transamerica*, 902 F.2d at 1544. Presumably, a section 162 deduction was not at issue because of the capital nature of the expenditure.

224. See Treas. Reg. § 1.170A-1(c)(5) (as amended in 1990).

225. I.R.C. § 162(b) (1988) (providing that any transfers which qualify for the charitable contribution deduction must be deducted under section 170 and cannot be deducted under section 162). The reason for this preference is to prevent taxpayers from circumventing the ceiling limitations imposed on charitable deductions. Ordinary and necessary business expenses deductible under section 162 are not subject to any ceiling limitations. See *infra* notes 227-29 and accompanying text.

226. Treas. Reg. § 1.170A-1(c)(5) (as amended in 1990).

227. Section 162(b) provides: "No [ordinary and necessary business] deduction shall be allowed under subsection (a) for any contribution or gift which would be allowable as a deduction under section 170 were it not for the percentage limitations . . . set forth in such section." I.R.C. § 162(b) (1988). See *infra* note 229 (explaining the predecessor of section 162(b)).

228. Again, this assumes that a corporation's transfers to charity are near the 10% limitation. Statistics indicate that this is not the case. See *supra* notes 63, 66 (showing that 1992 corporate contributions were \$6 billion and 1992 corporate pre-tax income was \$371.6 billion).

229. The legislative history for the predecessor of section 162(b) attempted to provide guidance. Section 23(a)(2) of the Revenue Act of 1938, Pub. L. No. 75-554, 52 Stat. 447. Section 23(a)(2) was later redesignated 23(a)(1)(B) of the Internal Revenue Code of 1939. The House Ways and Means Report stated:

As under present law, [the limitation contained in the predecessor of 162(b)] applies

Under section 162(b), the courts and the IRS must determine whether a corporate transfer to charity represents a quid pro quo exchange.<sup>230</sup> For example in *Singer*,<sup>231</sup> the Court of Claims accepted Singer's belief that the sale of its sewing machines to schools at a discount would increase future sales.<sup>232</sup> The court held that Singer could not deduct the value of the discount under section 170 because of its anticipated benefit. This perceived benefit revealed a quid pro quo exchange, notwithstanding the long-term nature of the benefit.<sup>233</sup> Furthermore, the court held that Singer did not have to realize the anticipated benefits.<sup>234</sup>

Because a corporation can deduct a transfer to charity under section 162, the repeal of the corporate section 170 deduction will not end favorable tax treatment for corporate giving or increase the cost of most corporate giving.<sup>235</sup> Accordingly, the repeal should have no

only to gifts, i.e. those contributions which were made with no expectation of a financial return commensurate with the amount of the gift. For example, the limitation would not apply to a payment by an individual to a hospital in consideration of a binding obligation to provide medical treatment for the individual's employees. It would apply only if there were no expectation of any quid pro quo from the hospital.

H.R. Rep. No. 1337, 83d Cong., 2d Sess. 44 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess., 196 (1954). The enactment of the 1954 Internal Revenue Code redesignated section 23 (a)(1)(B) to its present section 162(b) and extended its coverage to include individuals. I.R.C. § 162(b) (1988). No other substantive changes were made or have since been made.

230. In such cases, the corporate taxpayer wants to qualify the transfer as a section 162 deduction and must establish that it received a "commensurate financial benefit in return" for the transfer. See e.g., *Singer Co. v. United States*, 449 F.2d 413, 420 (Ct. Cl. 1971) (discussing the section 162 deduction requirement that "gifts are contributions made with no expectation of financial return commensurate with the amount of the gift"). *Contra* Priv. Ltr. Rul. 8145020 (July 30, 1981) (ruling a contribution by local newspaper business to fund first grade reading program results in only incidental business benefit and, therefore, thereby fails to show direct business relationship as required by the regulations under section 162).

231. 449 F.2d 413 (Ct. Cl. 1971).

232. Part II, Section B provides a discussion of corporate giving as a means to increase future markets. See *infra* notes 410-34 and accompanying text.

233. "[I]n reference to the discounts granted to the school, [Singer] expected a return in the nature of future increased sales. This expectation, even though perhaps not fully realized, provided a *quid pro quo* for those discounts which was substantial." *Singer*, 449 F.2d at 424. The court held that other charity discounts to hospitals and the like were charitable in nature because any benefits to Singer were incidental. *Id.*

234. Singer introduced evidence that only 1.75 percent of its regular customers "were influenced in buying a Singer machine by previous school training." *Id.* The court continued: "[t]his fact, if one accepts survey results as *fact*, does not change our opinion because even if [Singer's] expectations were not realized, the nature of the transaction is not changed from its initial character." *Id.*; see also *Stubbs v. United States*, 428 F.2d 885, 887 (9th Cir. 1970) (stating that the fact taxpayers never realized their anticipated economic benefits was not relevant under the section 70 analysis).

235. CLOTFELTER, *supra*, note 71, at 278 ("If the deduction for charitable contributions were limited or eliminated, corporations would have the incentive to substitute other deductible expend-

appreciable effect on federal revenue.<sup>236</sup> This, however, does not diminish the need for the repeal of the corporate charitable deduction. Although the repeal may not impact the federal fisc, it will remove the current reinforcement of the "halo effect" provided by section 170 and its underlying rationale that corporations give assets away out of a sense of disinterested social responsibility. This reinforcement of the "halo effect" increases the benefit associated with a corporate transfer to charity due to the mischaracterization of a transfer as a contribution or gift (i.e., not a quid pro quo exchange). In fact, the halo effect insures that corporations cannot make transfers to charity without expecting a commensurate benefit in return.

From a strictly doctrinal standpoint, the overlap between section 170 and section 162 is not complete and in many instances a corporate "charitable" transfer receives more favorable tax treatment than a business expense. With the exception of avoiding the 10% limitation imposed under section 170,<sup>237</sup> a taxpayer has little incentive to classify a transfer as a section 162 business expense, rather than a section 170 charitable contribution.

(a) The nondeductibility of goodwill

The section 162 deduction only applies to ordinary and necessary business *expenses*. This means that capital expenditures (i.e., generally those expenditures that produce a benefit beyond the taxable year, with an exception for most advertising costs)<sup>238</sup> are not immediately deductible. Capital expenditures must be capitalized (i.e., added to basis).<sup>239</sup> Thus, in the case of a transfer to charity constituting a capital expenditure, a corporation cannot "substitute" an immediate section 162 deduction for an immediate section 170 deduction.

In several reported cases, the IRS successfully recharacterized a corporate transfer to charity as a purchase of goodwill and further

---

itures for corporate gifts.") See Lashbrooke, *supra* note 9, at 222 (stating that if section 170 did not exist, state statutes authorizing corporate charitable contributions would become meaningless).

236. Compare Lashbrooke *supra* note 9, at 246 (discussing the proportionality of corporate charitable contributions to after tax income).

237. See *supra* notes 63, 66 (discussing studies showing that corporate giving does not approach the level such that the ceiling would act as a limitation).

238. Treas. Reg. § 1.162-14 (1969).

239. See generally I.R.C. §1016 (1994) and the addition to basis provisions. Section 197 adopted by the 1993 Act provides for the amortization of intangible property, including goodwill, on a straight-line basis over 15 years. *Id.* § 197.

classified the transfer as a nondeductible capital expenditure.<sup>240</sup> This highlights the disparate tax treatment of a commercial purchase of goodwill as compared to a charitable purchase of goodwill.<sup>241</sup>

(b) Transfers of appreciated or inventory property

Section 170 also provides more favorable treatment than section 162 where a corporation transfers either appreciated property or inventory property to charity. Under section 170, a taxpayer is entitled to deduct the full current fair market value of appreciated long-term capital gain property.<sup>242</sup> The taxpayer does not realize any gain on account of the transfer.<sup>243</sup> Under section 162, a taxpayer is entitled to deduct the taxpayer's adjusted basis in the property and the taxpayer realizes gain equal to the difference between the taxpayer's adjusted basis<sup>244</sup> in the property and the full fair market value of the property on the date of the transfer.<sup>245</sup>

Under section 170, a taxpayer generally is entitled to deduct only its basis or cost in inventory property transferred to charity.<sup>246</sup> However, section 170(e) provides corporations an enhanced deduction<sup>247</sup> for certain types of inventory property<sup>248</sup> transferred to specific

240. See, e.g., *Transamerica Corp. v. United States*, 254 F. Supp. 504, 515 (N.D. CA. 1966) (finding a transfer of real estate to the City of Oakland was a capital expenditure because the benefits received "(e.g., accessibility to an adjoining street and the elimination of annual resurfacing costs) indicates a capital expenditure the benefits of which will extend for more than one year — the usual dividing line between deductible expenses and capital expenditures"), *aff'd* 392 F. 2d 522 (1968); *Dockery v. Commissioner*, 37 T.C.M. (CCH) 317, 321 (1978) (holding the cost of construction of a waterline subsequently transferred to city served a business purpose and must be capitalized under section 263). Yerkes, *supra* note 129, at 169 n.57 ("[C]ourts will often classify a denied corporate charitable contribution as a capital expenditure, which is a non-deductible expense under § I.R.C. 263 (1976).").

241. For a discussion of corporate transfers to charity as a purchase of goodwill, see *supra* note 96 and accompanying text.

242. The property is valued at its fair market value on the date of the transfer. I.R.C. § 170(e)(1)(A) (1988).

243. See *supra* notes 202-03 (discussing the relevance of the donor's gain to deductibility).

244. See I.R.C. § 1001(a)(1988) (defining gain as the excess of the 'amount realized' as defined in section 1001(b) over the adjusted basis as defined in section 1011).

245. This assumes that the property is used to 'purchase' a benefit of equal value.

246. I.R.C. § 170(e)(1)(A) (1988).

247. See *id.* § 170(e)(3)(B) (permitting 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 amount of taxpayer's basis).

248. See *id.* § 170(e)(4)(B) (providing favorable treatment for "qualified research contributions."). In addition to other requirements, such contributions must consist of "scientific equipment or apparatus substantially all of the use of which by the donee is for research or experimentation . . . or for research training, in the United States in physical or biological sciences." *Id.* § 170(e)(4)(B)(v).

charitable organizations for particular purposes.<sup>249</sup> For qualifying transfers, section 170(e) permits a corporation to deduct its basis or its cost plus one-half of the difference between its basis or cost and the property's market (or sales) value.<sup>250</sup> Under section 162, a taxpayer is only entitled to deduct its basis or cost and the taxpayer may realize ordinary income on account of the transfer.<sup>251</sup>

#### 4. The Corporate Level Deduction

If a corporation is authorized to make a transfer to charity, it follows that the deduction for the transfer should be claimed at the corporate level.<sup>252</sup> Critics of the corporate deduction maintain that a corporate transfer to charity is a substitute for an individual contribution, on behalf of either the shareholder/owners or the corporate managers.<sup>253</sup>

##### (a) A constructive dividend?

A corporate transfer to charity is deductible by the corporation. The value of the transfer is not included in a shareholder's gross income even where the shareholder owns a controlling interest in the corporation and has the authority to determine the identity of the charitable donee.<sup>254</sup> Commentators suggest that corporate transfers to charity are constructive dividends to the shareholder/owner.<sup>255</sup>

---

249. *Id.* § 170(e)(3)(A)(i) (providing favorable treatment for transfers of inventory to a qualified charity where "the property is to be used by the donee solely for the care of the ill, the needy, or infants").

250. *Id.* § 170(e)(3)(B).

251. *Id.* § 162(a).

252. Of course, this is not the case with a Subchapter S corporation defined generally under section 1361 as a closely-held corporation with 35 or fewer shareholders. *Id.* § 1361(a)(1), (b)(1)(A) (West Supp. 1994). The shareholders of a Subchapter S corporation report their pro rata share of most items of deduction, profit and loss. *Id.* § 1366(a). With the certain limited exceptions, the corporate entity is disregarded for tax purposes and there is no tax at the corporate level. *Id.* § 1363(a).

253. Davis, *supra* note 119, at 15. See Earl F. Davis and Walter C. McGill, Jr., *Corporate Charitable Contributions and the Constructive Dividend Problem*, 8 J. CORP. TAX'N 323, 330 (1982) (calling corporate contributions "assignments of income").

254. Rev. Rul. 79-9, 1979-1 C.B. 125 holds that a corporate charitable contribution is not treated as a constructive dividend taxable to a *controlling* shareholder even where the shareholder has the right to select the charitable donee. The only exception is where the shareholder (or his or her family) receives an economic benefit by reason of the transfer. Revenue Ruling 79-9 also explains the acquiescence of the IRS in *Knott v. Commissioner*, 67 T.C. 681 (1977). See also GCM 37282 (September 30, 1977) (recommending that the IRS acquiesce to the decision in *Knott*).

255. Davis, *supra* note 119, at 67 (stating that corporations are the "charitable agents" of their

If a corporate transfer to charity is a perfect substitute for a transfer by a shareholder/owner,<sup>256</sup> then the ability to claim the deduction at the corporate level produces a favorable tax benefit for the shareholder/owner. For tax purposes, the shareholder/owner benefits from the corporate level deduction provided the alternative is for the corporation to declare a dividend of \$100x to the shareholder/owner which the shareholder/owner then transfers to a qualified charity.<sup>257</sup> In such case, the dividend is not a deductible expense of the corporation and the shareholder/owner must include the \$100x in gross income.<sup>258</sup> Although the shareholder/owner is entitled to deduct the transfer under section 170, the \$100x he or she transfers to charity does not offset gross income on a dollar for dollar basis because the individual charitable contribution deduction is an itemized deduction, subject to certain limitation for high income individuals.<sup>259</sup>

Milton Friedman, who is not otherwise a fan of corporate giving,<sup>260</sup> cited this favorable tax treatment as one of the few justifications for corporate giving.<sup>261</sup>

stockholders).

256. This assumes that shareholders may not make charitable donations if the corporation has already contributed.

257. Davis, *supra* note 119, at 67 (stating that "permitting the corporation to make donations from pre-tax dollars effectively increases the federal tax subsidy from one-to-one to three-to-one"); Davis & McGill, *supra* note 253, at 323 (stating that closely held corporations should consider corporate contributions rather than personal contributions); Yerkes, *supra* note 129, at 167 n.358 ("[I]t is more advantageous for the controlling shareholder in a closely held corporation to make charitable contributions through the corporation rather than personally.").

258. Davis, *supra* note 119, at 67 n.271 (illustrating the potential tax savings generated by the deduction at the entity level assuming that corporate transfers are a perfect substitute for transfers by shareholder/owner).

259. The charitable contribution is an itemized deduction which reduces adjusted gross income. I.R.C. §§ 63(d), 67(b)(4) (1988) (defining "itemized deductions"). Such itemized or so-called "above-the-line" deductions are subject to certain phase-out limitations for high income individuals. See *id.* § 68(a) (Supp. IV 1992). The extent of the phase-out is limited to 20% of the taxpayer's otherwise allowable itemized deductions. *Id.* § 68(a) (2) (Supp. IV 1992). An individual taxpayer whose itemized deductions do not exceed the standard deduction (defined in section 63(c)) cannot claim any of his or her otherwise allowable itemized deductions. *Id.* § 63(b) (1988).

260. See Johnson, *supra* note 167, at 11 (discussing Friedman's views on corporate giving). In response to the question of what is the fundamental role of the corporation in society, Mr. Friedman stated:

To produce goods and services to satisfy the demands of the public. The role of the corporation is to serve as an intermediary between individuals in their capacity as workers, providers of capital, providers of organizational ability, and so on — that is to say, as resources — and individuals as consumers.

*Id.* at 14.

261. *Id.* The other justification is, of course, profit maximization. *Id.* ("Charitable activity in some cases may contribute to a corporation's making as much money as possible.").

[T]he tax laws enable a corporation's stockholders to make larger gifts through the corporation than they can make on their own because corporate contributions are deductible for corporate tax purposes and dividends are not. As a result, the corporation may serve its stockholders by acting as a conduit through which stockholders can use their money most effectively.<sup>262</sup>

The conclusion that the corporate level deduction is a benefit for the shareholders/owners assumes that the corporation is an aggregate of, or "conduit" for, its shareholders.<sup>263</sup> The separation of control from ownership,<sup>264</sup> mandates that the corporate managers and not the shareholder/owners develop corporate giving policy. Thus, the charitable choices of a corporation, as expressed by its managers, may not reflect the choices of its shareholders.<sup>265</sup>

Despite the concern raised generally over the separation of the control of corporate decisions from corporate ownership, research indicates that very few shareholders object to corporate transfers to charity.<sup>266</sup> At least one corporation has attempted to introduce a direct correlation between shareholder dividends and corporate contributions.<sup>267</sup> In 1981, Berkshire Hathaway began allowing each shareholder to allocate a portion of his or her dividend to one of three preselected charities.<sup>268</sup>

---

262. *Id.*

263. Davis, *supra* note 119, at 67 (stating that corporations are the "charitable agents" of the stockholders).

264. BERLE & MEANS, *supra* note 37, at 119-26. See *infra* notes 269-72 and accompanying text (discussing some commentators' belief that corporate contributions are part of corporate managers' compensation packages).

265. This assertion is one of the principal concerns expressed by Professor Davis. See Davis, *supra* note 119, at 65 (asking "[w]hy should the wealth of corporations permit them to preempt the charitable choices of the very shareholders to whom that wealth could otherwise be distributed?").

266. KOCH, *supra* note 163, at 27 (reporting that 98% of IBM shareholders voted against a measure that would adversely affect corporate contributions). Of course, the failure of shareholders to object could support the notion of "shareholder abdication" over matters of corporate governance.

267. This approach bears a striking resemblance to the Red Cross Dividend Program. See *supra* notes 88-91 and accompanying text (discussing the Red Cross Dividend Program). However, in the case of Berkshire Hathaway the purpose is not to circumvent states laws restricting corporate actions. Rather, the intent is to vest the shareholder/owners with some control over corporate giving. See *supra* notes 88-91 and accompanying text.

268. Davis, *supra* note 119, at 65; Johnson, *supra* note 167, at 14-15. In addition, many corporations have instituted "matching gift" programs where the corporation matches an employee's contribution to limitations on dollar amounts and the type of charitable recipients. See *infra* note 420 (explaining General Electric's introduction of matching gift programs in the area of educational institutions).



(b) Compensation to the manager?

Recognizing that corporate managers and not shareholders/owners have dominion and control over the expenditure of a corporation's charitable giving budget, some commentators suggest that corporate transfers to charity represent part of the compensation package of corporate managers.<sup>269</sup> If a corporate transfer to charity is really a substitute for a transfer by a corporate manager, then the ability to claim the deduction at the corporate level produces a favorable tax benefit for the corporate manager. For tax purposes, the manager benefits from the corporate level deduction provided the alternative is for the corporation to pay the manager an additional \$100x in compensation which the manager then transfers to a qualified charity. In such case, the additional compensation is a deductible expense of the corporation, but the manager must include the \$100x in gross income. Although the manager is entitled to deduct the transfer under section 170, the \$100x he or she transfers to charity does not offset gross income on a dollar for dollar basis because the individual charitable contribution deduction is an itemized deduction, subject to certain limitation for high income individuals.<sup>270</sup>

Absent a direct payment of the \$100X from the corporation to the manager, current interpretation of the tax laws does not characterize the \$100x as compensation because the manager is "merely performing administrative duties for the corporation by suggesting specific qualified recipient organizations."<sup>271</sup> Such interpretation does not recognize the potential for corporate managers to use corporate giving as a form of social currency.<sup>272</sup>

---

269. See Davis, *supra* note 119, at 16 ("corporate managers as arbiters of social welfare").

270. The charitable contribution is an itemized deduction which reduces adjusted gross income. I.R.C. §§ 63(d), 67(b)(4) (1988) (defining "itemized deductions"). Such itemized or so-called "above-the-line" deductions are subject to certain phase-out limitations for high income individuals. See *id.* § 68(a) (Supp. IV 1992). The extent of the phase-out is limited to 20% of the taxpayer's otherwise allowable itemized deductions. *Id.* § 68(a)(2) (Supp. IV 1992). Individuals whose itemized deductions do not exceed the standard deduction (defined in section 63(c)) cannot claim any of their otherwise allowable itemized deductions. *Id.* § 63(b) (1988).

Unlike the corporation, the manager would have little incentive to substitute a section 162 deduction because unreimbursed employee business expenses are miscellaneous itemized deductions. See *id.* § 67(b). The manager is entitled to deduct such expenses only to the extent that in the aggregate they exceed 2% of the manager's adjusted gross income, subject to the phase-out discussed above. See *id.* §67(a); 68(a) (Supp. IV 1992).

271. Rev. Rul. 67-137, 1957-1 C.B. 63.

272. See *infra* notes 455-68 and accompanying text (discussing corporate giving as social currency).

## II. CORPORATE GIVING: ITS MANY EXPLANATIONS AND MANIFESTATIONS

### A. The "Halo Effect" and What Corporations Say They Expect to Get When They Give

#### 1. Tax Deductibility as the *Sine Qua Non* of Corporate Giving

Many legal commentators and economists believe that the favorable federal income tax treatment afforded corporate transfers to charity explains the paradox of corporate giving.<sup>273</sup> However, the history of corporate philanthropy and the failure of economists to predict changes in corporate giving patterns, illustrates that the deductibility of corporate transfers to qualified organizations is not sufficient to explain the persistent practice of corporate giving.<sup>274</sup> Legal scholars and economists assume that corporate giving involves a transfer of corporate assets without the expectation of receiving a commensurate benefit in return. Accordingly, they look only to the tangible tax benefits in an effort to explain what they perceive as irrational corporate behavior.

Legal scholarship mistakenly accepts and advances tax deductibility as the *sine qua non* of corporate giving.<sup>275</sup> For example, Professor Green asked and answered, "What is the motivation for such [corporate] philanthropy? Admittedly, many individuals and businesses give simply to realize the tax benefits."<sup>276</sup> No other explanation is offered. But, as explained more fully in Part I, Section C, the "tax benefits" associated with corporate giving merely reduce the cost of such giving.<sup>277</sup> Despite deductibility, each dollar transferred to charity represents a dollar not distributed to shareholders, or otherwise used or retained by the corporation. Professor Lashbrooke vigorously advocated the repeal of the corporate charitable deduction under section 170 because it would "require corporations to justify all expenditures in terms of profit maximization and business

---

273. See, e.g., Blumberg, *supra* note 129 (discussing business participation involving the use of corporate funds); Green, *supra* note 60 (discussing corporate contributions, benefits, and motivation behind giving); Lashbrooke, *supra* note 9 (discussing the existence of the section 170 deduction for corporations and its relation to resources, social responsibility, and moral welfare).

274. See *supra* notes 73-176 and accompanying text (discussing the history of corporate charitable giving).

275. See *supra* note 273 (citing examples of works which advocate this view).

276. Green, *supra* note 60, at 240.

277. See *supra* text accompanying notes 177-272 (discussing the structure of the federal income tax corporate charitable deduction).

purpose."<sup>278</sup> He concluded:

*Repeal of section 170 with respect to corporate charitable contribution deductions would effectively stop corporate charitable giving, whether authorized by state statute or justified on the basis of corporate social responsibility, because corporate giving is bottom line oriented. In the absence of a tax deduction, corporations would have no incentive to give corporate assets to charity.*<sup>279</sup>

Similarly, Professor Blumberg contended that corporations undertake social responsibility programs, including transfers to charity, only to the extent that such expenditures receive favorable tax treatment.<sup>280</sup> Blumberg stated: "[T]he tax test may . . . be the decisive test of validity in a tax-oriented business world. It is plain that, as a practical matter, corporate activities in the social sphere will be undertaken *only if* the expenditures are tax-deductible."<sup>281</sup>

Congress enacted the corporate charitable contribution deduction in 1935 to encourage existing behavior, not to create new expressions of corporate action. Corporate giving existed in the absence of the deduction, and despite the fact that corporate transfers to charity were considered *ultra vires* under the laws of many states.<sup>282</sup> Given that corporate giving pre-existed the enactment of the deduction, the motivation for corporate giving cannot lie solely within the four corners of section 170.<sup>283</sup>

278. Lashbrooke, *supra* note 9, at 223. "These [individual and corporate charitable giving] statistics reflect the altruism and generosity of the American people. Corporations, however, do not give based on altruism or generosity but on tax consequences." *Id.* at 227.

279. *Id.* at 248 (emphasis added). Professor Lashbrooke continued, "Some limited corporate giving might still be justified as ordinary and necessary business expenses and, hence, would be deductible under section 162; however, if section 170 were repealed the courts would scrutinize such expenditures more carefully." *Id.* Despite Professor Lashbrooke's recognition of the section 162 potential substitution, he argues for repeal on the basis of lost federal revenue. Professor Lashbrooke states, "Given the state of the federal budget and the now expressed need to raise taxes, we can not afford to continue to let as much as \$1.7 billion dollars annually leak out of the federal treasury through the section 170 corporate charitable deduction." *Id.* at 222.

280. Blumberg, *supra* note 129, at 180.

281. *Id.* (emphasis added).

282. See *supra* notes 71-116 and accompanying text (discussing how transfers to charity were *ultra vires* in many states and the ways Congress, corporations, and charities addressed the issue); see HALL, *supra* note 97, at 58 (describing extensive corporate transfers to charity during the first half of the twentieth century). Hall cited a survey of corporate contribution to various charities in 37 cities during the 1920s and reported that corporate gifts accounted for an average of 20% of the total funds raised. *Id.* Hall concluded: "Although there was no tax incentive for charitable giving by corporations, and under the law in many states such giving was illegal, the practice continued on a surprisingly large scale." *Id.*

283. See *id.* (describing corporate giving prior to the enactment of section 170). Hall criticized the assertion by Andrews that the creation of corporate foundations was "clearly related to corpo-

Beyond the legal academy, the prevailing explanation of corporate giving identifies business benefits as the motivating force. The tax treatment of corporate contributions is considered an ancillary factor.<sup>284</sup> For example, in 1956, Richard Eells, one of the first commentators on corporate giving, observed correctly that corporate transfers to charity still “cost the shareowners *something*”<sup>285</sup> and, therefore, tax treatment alone could not explain corporate giving. As Eells explained, the threshold question confronting a corporation contemplating a transfer to charity is “whether to make it at all.”<sup>286</sup> While a corporation may transfer more because of the deduction, the steady rise in corporate giving despite fluctuating tax rates confutes any assumption that the amount of corporate transfers correlates directly to the real, after-tax cost of the transfer.<sup>287</sup>

Economists predicted that the 1986 reduction of tax rates<sup>288</sup> would cause a decline in charitable giving.<sup>289</sup> For example,

---

rate tax chronology.” *Id.* at 61 (citing ANDREWS, *supra* note 79, at 29). Hall cautioned, “Although the increases [in the formation of corporate foundations] may be accounted for solely in terms of tax chronology, it is worth noting that there were other powerful forces influencing corporate givers . . . .” *Id.*

284. For a discussion of a survey of CEO’s concluding that the tax treatment is not a significant consideration, see *infra* notes 297-99 and accompanying text (citing a survey conducted in 1981 and 1982).

285. EELLS, *supra* note 74, at 150. Eells explained:

*The philanthropic responsibilities and opportunities of corporations arise independently of tax-exemption privileges and cannot properly be made to depend upon current tax policies alone. Corporate giving has its own quid pro quo. The fact that a company-donor gets a good “tax bargain” is not the real justification for a tax-exempt gift. The gift, after all, does cost the shareowners something. The question is whether to make it at all. If there is good ground for the expenditure, it should be made whether or not it is tax exempt.*

*Id.*

286. *Id.*

287. See *supra* notes 62-67 (describing a steady increase in corporate giving throughout the 1980’s despite the passage of the 1986 Tax Reform Act).

288. The Tax Reform Act of 1986 reduced the top marginal rate of tax on corporate income from 46% to 34%. I.R.C. § 11 (West 1994). As a result, the after-tax cost of a fully deductible \$100x corporate transfer to charity increased from \$54x to \$66x. See *infra* notes 294-96 and accompanying text (discussing the Tax Reform Act’s corporate tax reduction impact on corporate giving).

289. Clotfelter addressed the impact on corporate giving of the 1986 Tax Reform Act reduction in the top marginal corporate tax rate from 46% to 34% and concluded: “Based on available econometric evidence, the resulting increase in the net cost of making gifts will result in a modest decline in corporate giving, on the order of 5 percent.” Charles T. Clotfelter, *Federal Tax Policy and Charitable Giving*, in PHILANTHROPIC GIVING: STUDIES IN VARIETIES AND GOALS, *supra* note 11, at 115; see also Jerald Schiff, *Tax Policy, Charitable Giving, and the Non Profit Sector: What Do We Really Know?*, in PHILANTHROPIC GIVING: STUDIES IN VARIETIES AND GOALS, *supra* note 11, at 128, 137-38 (citing estimated reduction for total giving but concluding: “Tax reform will affect the charitable sector in ways that are much more far reaching than simply

Clotfelter projected a 5% decline in corporate giving<sup>290</sup> and a 15% decline in charitable giving by individuals.<sup>291</sup> This econometric analysis assumed that tax policy is the primary factor in determining the amount to give, affecting corporate giving in two ways: (1) the charitable deduction reduces the after-tax cost of the transfer, and (2) the rate of tax determines the after-tax income of the donor.<sup>292</sup> Thus, a reduction in a donor's rate of tax increases the after-tax cost of the transfer, but also increases the donor's after-tax income.<sup>293</sup> Corporate transfers continued to increase annually between 1987 and 1991,<sup>294</sup> despite the recession and an inconsistent trend in corporate pre-tax income.<sup>295</sup> Econometric projections failed to anticipate the post-1986 increase in corporate giving<sup>296</sup> because changes in income cannot explain corporate giving patterns.

A recent survey of chief executive officers concerning their companies' corporate giving programs confirms that tax benefits are not the primary consideration of corporate donors.<sup>297</sup> In fact, the CEOs responded overwhelmingly that tax incentives do not significantly influence their corporate giving patterns. When specifically asked

reducing donations of money by individuals.").

290. See *supra* note 67 (citing Clotfelter's 5% decline projection).

291. Charles T. Clotfelter, *Federal Tax Policy and Charitable Giving*, in *PHILANTHROPIC GIVING: STUDIES IN VARIETIES AND GOALS*, *supra* note 11, at 114; see also Jerald Schiff, *Tax Policy, Charitable Giving, and the Non Profit Sector: What Do We Really Know?*, in *PHILANTHROPIC GIVING: STUDIES IN VARIETIES AND GOALS* *supra* note 11, at 132 (summarizing the reduction estimates for individuals which ranged from 14.2% to 17.7%). The expected higher reduction in individual giving was due, in part, to the expiration of the above-the-line charitable deduction for nonitemizers. As a result of the expiration of the provision, an individual whose aggregate itemized (below-the-line) deductions (including any transfers to charity) do not exceed the standard deduction can no longer claim a charitable deduction. *Id.*

292. Tax policy also determines the extent of the reduction in the cost of the transfer. See *supra* notes 177-81 and accompanying text.

293. See CLOTFELTER, *supra* note 71, at 172 ("[T]he tax affects a corporation's after-tax net income as well as its price of giving.").

294. See *supra* note 63 (citing corporate giving statistics).

295. See *supra* note 66 (citing corporate pre-tax income statistics).

296. See *supra* notes 288-93 and accompanying text (discussing economists predictions of the 1986 reduction of tax rates). This Article is concerned solely with corporate giving and argues that corporations make transfers to charity to realize a return benefit in the form of advertising services, public relations efforts to enhance goodwill, or an investment in future markets and future employees. Additional factors that could account for the increase in giving include increased fundraising efforts on the part of charitable organizations, and intensified public emphasis on giving and volunteerism.

297. Joseph Galaskiewicz, *Corporate Contributions to Charity: Nothing More Than a Marketing Strategy?*, in *PHILANTHROPIC GIVING: STUDIES IN VARIETIES AND GOALS* *supra* note 11, at 246, 251 (citing a survey of 219 chief executive officers conducted in 1981 and 1982 when the top marginal corporate tax rate was 46% and, therefore, the after-tax cost of a \$100x transfer to charity was only \$54).

whether tax laws are an incentive to giving, the response was equivocal: "Only 26 percent of [the] respondents said that tax laws provided 'great' or 'substantial' incentives, 36 percent said 'some' incentives, and 36 percent said 'very slight' or 'no' incentives."<sup>298</sup> Only 12% of the CEO's surveyed stated that tax savings is an "extremely" or "very important" goal.<sup>299</sup>

## 2. *The Perceived Business Benefit of Corporate Giving*

Because corporations do not make transfers to charity merely "to realize the tax benefits",<sup>300</sup> another reason must exist to explain why corporations transfer billions of dollars to charity each year. Marketing and fundraising literature explains that a corporate transfer to charity increases corporate/shareholder profit and gain.<sup>301</sup> Associating with a charity or a charitable cause can enhance a corporation's image much the same way as advertising or public relations initiatives.<sup>302</sup> Studies of corporate budgets confirm this perception and suggest that a corporation may use transfers to charity to complement or supplement its advertising/marketing budget.<sup>303</sup>

There is some evidence of an association between industry type

---

298. *Id.*

299. *Id.*

300. See *supra* notes 273-99 (discussing corporate giving as not directly related to realization of tax benefits). But see Green, *supra* note 60, at 240 (discussing the view that the primary motivation behind corporate transfers to charity is the realization of tax benefits).

301. Nearly forty years ago, Eells asserted that corporate giving produces valuable benefits beyond that of the tax deduction. EELLS, *supra* note 74, at 33. Eells wrote, "Charitable contributions carry important advantages for the donor. The fact that these disbursements may be eligible for tax exemption is becoming a secondary consideration. Philanthropy provides tangible good will and recognition of the company as a good corporate citizen." *Id.*

302. See *infra* notes 333-409 and accompanying text (discussing the relationship between corporate giving, advertising, and public relations).

303. Joseph Galaskiewicz, *Corporate Contributions to Charity: Nothing More Than a Marketing Strategy?* in PHILANTHROPIC GIVING: STUDIES IN VARIETIES AND GOALS *supra* note 11, at 246, 247. Galaskiewicz described three studies establishing "an empirical association between advertising and contributions expenditures" and "argu[ing] that the two are really indistinguishable." *Id.* Useem also noted the connection between advertising and corporate giving. He wrote: A final indicator of the importance of philanthropy for purely company advance is its association with advertising. Comparison of interindustry variations in expenditures for advertising and philanthropy finds a high correlation between the two, *implying that philanthropy is treated in part as an extension of marketing*. Similarly, a study of America's 55 largest electric utilities in 1976 reveals that the level of their charitable contributions is closely tied to their spending on customer services and advertising.

USEEM, *supra* note 119, at 125-26 (emphasis added). Useem suggested that classwide interests provide a strong secondary consideration in corporate giving patterns. See *infra* text accompanying notes 455-61 (describing corporate giving, classwide interests, and the inner circle).

and size and the level of corporate giving, further suggesting that corporate managers perceive that corporate giving produces a business benefit. In a study of the corporate giving patterns of certain industry groups, Clotfelter reported a correlation between consumer contact and corporate giving.<sup>304</sup> The study found that corporations in service industries with direct consumer contact (e.g., "banking, retail trade, and food products") contributed a higher percentage of net income than corporations with little direct consumer contact.<sup>305</sup> Clotfelter noted that industries without direct consumer contact (such as holding companies and mining concerns) exhibited the lowest level of corporate giving.<sup>306</sup> Using a profit-maximization model of corporate purpose,<sup>307</sup> Clotfelter explained that well-placed corporate transfers to charity can increase corporate revenue because the community targeted by the transfers is more hospitable to the corporation and its employees.<sup>308</sup> The more exposure an industry has to the public, the more dependent it is upon public relations efforts. If the industries that spend the most on corporate giving are the same industries that have the most consumer contact (and are the most dependent on public relations), then corporate giving must have either advertising or public relations benefits.

Clotfelter also reported studies analyzing the relationship between

---

304. See CLOTFELTER, *supra* note 71, at 173-76 (documenting the study which involved corporate giving patterns for 1980 and measured giving as a percentage of corporate net income).

305. *Id.* at 173.

306. *Id.* This correlation between corporate giving and contact with consumers is supported by the studies described by Galaskiewicz. See *supra* note 303 and accompanying text (referring to the studies). Galaskiewicz concluded that the level of corporate giving is "directly associated with the percentage of sales to households." Joseph Galaskiewicz, *Corporate Contributions to Charity: Nothing More Than a Marketing Strategy?*, in PHILANTHROPIC GIVING: STUDIES IN VARIETIES AND GOALS *supra* note 11, at 246, 247.

307. In general, a profit-maximization model assumes that the purpose of a corporation is to maximize shareholder profit and gain. See *supra* notes 120-52 and accompanying text (comparing the profit-maximization model of corporate purpose to the social responsibility model). Clotfelter also considered corporate giving under a model of utility maximization where managers and shareholders "derive utility from making contributions" and noted that managers often make corporate giving decisions with reference to "rules of thumb" based on past giving and industry norms. CLOTFELTER, *supra* note 71, at 190-92.

308. Clotfelter wrote:

One way costs may be reduced is if contributions have the effect of making a community a more desirable place in which to live and work and if this reduces the level of wages a company must pay. Or a company's good public image may reduce other costs, for example, by making zoning changes easier or reducing the costs of vandalism.

*Id.* at 188.

industry concentration and the level of corporate giving.<sup>309</sup> The original hypothesis of one study stated that monopolistic firms would be more inclined to act as good corporate citizens.<sup>310</sup> Instead, oligopolistic or "rival" firms had the highest percentage of corporate giving, suggesting that rival corporations use transfers to charity to gain a "comparative advantage."<sup>311</sup>

This perceived comparative advantage is just one way corporate managers justify, and fundraisers encourage, corporate giving.<sup>312</sup> They also describe corporate giving as the equivalent of (or substitute for) various types of corporate expenditures, based on how directly the corporation enjoys the anticipated benefit. From most to least direct, these corporate expenditures fall into three categories: advertising and marketing, public relations, and an investment in future markets and future employees.<sup>313</sup>

Marketing and fundraising texts assert that each type of corporate giving provides a financial benefit to the corporate donor.<sup>314</sup>

---

309. *Id.* at 201 (citing Orace Johnson, *Corporate Philanthropy: An Analysis of Corporate Contributions*, 39 J. Bus. 489 (1966)). Clotfelter noted that a 1981 study by Maddox and Siegfried based on 1963 data from certain minor industries indicated that the level of corporate transfers to charity rise with an increase in industry concentration. *Id.*

310. The hypothesis was that monopolistic firms would place a greater emphasis on corporate giving as a means of exercising or illustrating the social power inherent with industry concentration. *Id.*

311. *Id.* (quoting Johnson, *supra* note 167, at 497). Useem cited the correlation between advertising and corporate giving to illustrate that corporate managers use transfers to charity to advance the direct economic interests of the corporation. USEEM, *supra* note 119, at 125-26.

312. See Craig Smith, *Giving is More Than Its Own Reward*, N.Y. TIMES, Feb. 28, 1993, §3, at 25 (discussing various ways philanthropy can benefit a corporation). Fundraisers must "abandon advocacy in favor of a new approach that demonstrates explicitly how philanthropy can benefit the company in the long run." *Id.*

313. Various commentators have categorized corporate transfers based on the underlying business motivation. For example, Useem constructed an elaborate critique of corporate giving as a vehicle for the transmission and advancement of certain classwide interests shared by corporate managers. USEEM, *supra* note 119, at 121-26. Incorporating Useem's "social currency" theory, Galaskiewicz analyzed corporate giving as advertising, public relations, enlightened self-interest, tax strategy, and "social currency." Joseph Galaskiewicz, *Corporate Contributions to Charity: Nothing More Than a Marketing Strategy?*, in PHILANTHROPIC GIVING: STUDIES IN VARIETIES AND GOALS *supra* note 11, at 246, 246-52. Haley discussed the "strategic uses of contributions in social systems" and identified three such uses for corporate transfers to charity: "First, managers use contributions to acquire audiences by capturing the attention of key stakeholders. Second, managers use contributions to mime messages by symbolically transmitting corporate interests to other stakeholders. Finally, managers use contributions to vend values by institutionalizing them in society." Usha C. V. Haley, *Corporate Contributions as Managerial Masques: Reframing Corporate Contributions as Strategies to Influence Society*, 28 J. MGMT. STUD. 485, 494 (1991).

314. Galaskiewicz differentiated public relations from advertising on the basis that public relations "target[s] the entire public and [is] not aim[ed] specifically at increasing sales. Its goal is to show that the firm is a good corporate citizen." Joseph Galaskiewicz, *Corporate Contributions to*



Thus, the ultimate goal of corporate giving (regardless of type) remains that of profit maximization.<sup>315</sup> Interestingly, there is no empirical evidence indicating that corporate giving increases corporate profits.<sup>316</sup> Useem stated, "there is practically no evidence of any strong association among socially relevant behaviors, whether desirable or undesirable, and any of the usual indicators of economic success."<sup>317</sup> Still, the belief that corporate giving is good for business persists, and marketing and fundraising literature urges managers to operate corporate giving programs as they would any other corporate undertaking.<sup>318</sup>

---

*Charity: Nothing More Than a Marketing Strategy?*, in PHILANTHROPIC GIVING: STUDIES IN VARIETIES AND GOALS *supra* note 11, at 246, 248. See *infra* notes 392-409 and accompanying text (discussing the relationship between corporate giving and public relations).

315. See Alex J. Plinio & Joane B. Scanlan, *Total Resource Leveraging and Matching: Expanding the Concept of Corporate Community Involvement*, in THE CORPORATE CONTRIBUTIONS HANDBOOK, *supra* note 74, at 283-84 (advocating an integrated approach to corporate giving programs which recognizes the need to include "marketing, issues management, direct contributions, foundation management, employee matching contributions, scholarships, and external communications"); see also Smith, *supra* note 63, at 25 (noting that 40% of leading corporate donors have applied total "quality-management" to their giving programs); Lois Therrien, *Corporate Generosity is Greatly Depreciated*, Bus. Wk., Nov. 2, 1992, at 118 (noting study of 100 large corporate donors, 38 of which had adopted "strategic plans" thereby "abandoning their traditional passive, scattershot approaches and consolidating a hefty portion of their donations in a few causes").

316. See Haley, *supra* note 313 (discussing how corporate contributions are used to promote managerial corporate interests). Like Useem, Haley believed that corporate managers use contributions in various strategic ways to secure power and influence. *Id.* Haley offered the following critique of the corporate giving decision-making process:

Many managers publicly claim that they use contributions to enhance corporate image, to improve sales, to ease recruitment, to constitute necessary public relations, to provide obligatory evidence of corporate responsiveness to society, and therefore to improve profits. Substantiations of such claims do not exist. There is practically no evidence to indicate that managers enquire into the profit implications of contributions . . . [C]ontribution decisions lack structure, standardization, and objectivity: anecdotal reporting and poor documentation permeate these decisions . . . Despite managerial claims, there are almost no corporate data to verify that contributions affect corporate profits.

*Id.* at 491-92 (citations omitted).

317. USEEM, *supra* note 119, at 147 (citing Lee E. Preston, *Corporate Power and Social Performance: Approaches to Positive Analysis*, in RESEARCH IN CORPORATE SOCIAL PERFORMANCE AND POLICY 1-16 (1981)). Advancing his conviction that classwide considerations influence corporate giving, Useem continued: "If not company profits, what it is that does count, according to the present analysis, is the extent to which a firm is responsive to classwide considerations in reaching its decisions on matters of public concern." *Id.*

318. See Haley, *supra* note 313, at 492-94 (promoting integration of economic and social dimensions of contributions). Fundraising and marketing literature stresses the need for more cost-effective management of corporate contribution programs. See KOCH, *supra* note 163, at 13 ("The corporate contributions dollar must come up to the same measure of cost-effectiveness that is expected from the corporate dollar invested in research, marketing, production, or administra-

### 3. The "Halo Effect"

Corporate America's desire to capitalize on the goodwill associated with charity and charitable causes is central to the notion that corporate giving results in a benefit to the corporate donor.<sup>319</sup> Indeed, corporate giving relies on this goodwill — known in the marketing industry as the "halo effect"<sup>320</sup> — and it quite consciously trades on it. Marketing and fundraising literature blatantly advises corporations on how to take advantage of the privileged status afforded charity in contemporary society. The introductory paragraphs of a recent book entitled *Doing Best by Doing Good* provide a characteristically upbeat description of the mechanics of the "halo effect" and its many benefits.

People trust nonprofits. It's almost as simple as that. We tend to believe in what they do, and almost more importantly, in how they do it. They are tackling the most pressing problems of our time for reasons other than personal gain. For this, we tend to grant them respect. We acknowledge their integrity. We give them our trust. Business, of course, is not so fortunate. We all know that business's bottom line is profit . . . However, companies that associate closely with nonprofits . . . find that an interesting thing happens. The goodwill accorded the nonprofit rubs off on them. Supporters of the organization begin to look favorably on the company, even to buy its products if that will help the cause. The public at large may see the company in a different light — as one that cares about people as well as profits. The company's self-centered image is softened; its appeal to consumers

---

tion.") (emphasis omitted). The literature also urges corporations and their corporate grantmaking officials to resist the marginalization of corporate giving officers and to operate in a more business-like manner. See Therrien, *supra* note 315, at 118 (quoting foundation executives who refer to contributions as "social investments" from which they anticipate "strong returns").

319. The view that corporate giving produces corporate benefit is not universally held. For example, Milton Friedman expressed concern over what he considered irresponsible corporate funding of projects that are detrimental to "our system of private property." Milton Friedman, *The Adam Smith Address: The Suicidal Impulse of the Business Community*, BUS. ECON., Jan. 1990, at 5, 8-9. Commentators to the left of Friedman counter that corporations give to potentially troublesome organizations in an attempt to domesticate them. For a discussion of the delicate balance required of corporate giving, see *infra* notes 435-44 and accompanying text.

320. James W. Harvey & Kevin F. McCrohan, *Changing Conditions for Fund Raising and Philanthropy*, in CRITICAL ISSUES IN AMERICAN PHILANTHROPY 59 (Jon V. Til & Assoc. eds., 1990). The authors described the "halo effect" as follows:

Increasingly, corporate giving is seen not solely as philanthropy but rather as an established part of doing business, being present in the community and acting in the corporation's own self-interest. An additional benefit of corporate giving, regardless of the efficiency level of the philanthropy supported, is that perceptions of corporate social responsibility are higher for firms with greater levels of giving, even for those that had earlier violated the antitrust statutes. This finding supports the notion that corporate giving provides a *halo effect* that can overcome prior transgressions.

*Id.* (emphasis added).

grows.<sup>321</sup>

The "halo effect" is a function of the positive public perception of charity and charitable endeavors, including the simple act of writing a check.<sup>322</sup> The halo effect attaches to a corporation when it makes a transfer to charity and its name (or product or service) becomes associated with that charity. By publicizing its transfer, the corporation "generates favorable attitudes among employees, customers and the electorate."<sup>323</sup> The "halo effect" makes corporate giving a relatively effortless investment because "the corporation's only burden is to publish its efforts."<sup>324</sup>

Many corporations engage in strategic corporate giving to mask

321. STECKEL & SIMONS, *supra* note 7, at 13-14.

322. In recent years, the charitable sector has experienced a series of scandals generating bad publicity and risking a decline in donor confidence. Kristin A. Goss, *A Crisis of Credibility for America's Non-Profits*, THE CHRON. OF PHILANTHROPY, June 15, 1993, at 1. The questionable fundraising practices of certain organizations has prompted renewed interest in state laws regulating the solicitation of charitable funds. See Leslie G. Espinoza, *Straining the Quality of Mercy: Abandoning the Quest for Informed Charitable Giving*, 64 S. CAL. L. REV. 605 (1991) (discussing fund-raising cost regulation); Grant Williams, *Charity Fraud: States Intensify the Battle*, THE CHRON. OF PHILANTHROPY, Oct. 8, 1991, at 30 (discussing the increasing problem of fraudulent charities which exist only to assist corporations in acquiring goodwill). New federal income tax provisions impose stricter substantiation rules for contributions to qualified charitable organizations. See I.R.C. §§ 170, 501, 2055 (West 1994) (discussing charitable contributions and gifts, exemptions from tax on corporations, and transfers for charitable uses respectively). The publicity surrounding the questionable compensation package and spending patterns of the former President of the United Way focused public attention on excessive administrative expenses. See Bruce Millar & Jennifer Moore, *United Way: A Year Later, Controversy Lingers*, THE CHRON. OF PHILANTHROPY, Mar. 9, 1993, at 1 (discussing the United Way scandal). One of the most comprehensive accounts of the charitable sector was a 1993 seven part series of articles in the *Philadelphia Inquirer* entitled "Warehouses of Wealth: The Tax-Free Economy." The series has since been published. GILBERT M. GAUL & NEILL A. BOROWSKI, *FREE RIDE: THE TAX-EXEMPT ECONOMY* (1993).

323. Green, *supra* note 60, at 259. Fundraisers stress the importance of securing adequate press coverage. Steckel and Simons provided characteristically candid advice concerning publicity for corporate transfers to charity. STECKEL & SIMONS, *supra* note 7, at 199. Speaking to would-be corporate donors, the authors advised:

Let's be honest. You do public purpose partnerships because you want to make a difference. You want to contribute to a worthy cause. You want your employees to feel proud. *And you want the world to know.* If the world doesn't know — if you don't broadcast your campaign message loud and clear — you'll miss out on a lot of the benefits that can come from your good works. To get those benefits, you need to plan a strategic publicity campaign that will get you the kind of attention you want. This will be a little different from planning your conventional promotional campaign because with a public purpose partnership there are more angles open to you, and you want to take them all.

*Id.*

324. See *supra* note 323 (discussing publicizing corporate donations to induce the "halo effect").

or compensate for questionable social or environmental records.<sup>325</sup> Consumer surveys indicate that the "halo effect" (or lack thereof) may influence purchasing patterns of many consumers. A 1990 survey shows that 52% of the consumers asked would pay 10% more for a product that was "socially responsible."<sup>326</sup>

Many corporations are reluctant to fund an organization advocating the regulation of their industry. Other corporations choose to support charitable organizations that might criticize the corporation or its policies.<sup>327</sup> For example, the Seagram Beverage Company sponsored golf tournaments for the benefit of the Kidney Foundation. At least one commentator suggested that the sponsorship was an effort to counteract the association between drinking and kidney disease.<sup>328</sup> Regardless of Seagram's intent, the speculation illustrates how a charity's autonomy,<sup>329</sup> reputation, or goodwill can be compromised by ill-suited corporate sponsorship.<sup>330</sup>

On the other hand, some socially undesirable corporations report

---

325. USEEM, *supra* note 119, at 120 ("Exxon and other companies in the politically sensitive petroleum industry are among the most active supporters of arts on public television and elsewhere.").

326. STECKEL & SIMONS, *supra* note 7, at 48 (citing a 1990 Roper poll in which 67% replied that they considered the manufacturer's social record when purchasing). The lack of a "halo effect" can create a negative reaction among consumers. A poll of New Yorkers revealed that 25% had refused to purchase products based on the environmental performance of at least one manufacturer. *Id.* Consumers also seem to be aware of corporate giving or social responsibility programs. Useem reported a survey that indicated consumers could correctly identify those industries which spend more on social responsibility initiatives. USEEM, *supra* note 119, at 120 (citing Arthur H. White, *Corporate Philanthropy: Impact on Public Attitudes*, in CORPORATE PHILANTHROPY IN THE EIGHTIES 17-19 (1980)).

327. A. H. Robins pushed this reasoning to the extreme when it offered evidence of its corporate giving program during a criminal trial to demonstrate that it could not have known about the Dalkon Shield. PAYTON, *supra* note 168, at 22-23. One public opinion survey indicates that even among antitrust violators, the corporations with active giving programs enjoyed a more favorable rating. STECKEL & SIMONS, *supra* note 7, at 48.

328. Joe Mullich, *Sweet Charity*, BUS. J. N.J., April, 1992, at 21, 23.

329. This statement should not be read to imply that the charitable sector is an autonomous segment of the economy. Hall convincingly illustrated the dependence of the charitable sector (also known as the "independent sector") on both the private and the public sectors. Hall wrote: "The starting point for any serious consideration of the place of nonprofits in the American polity is to accept the policy implications of the scholarly recognition of sectoral interpenetration: that the nonprofit sector is a dependent sector, not an independent one." HALL, *supra* note 97, at 106.

330. Mullich, *supra* note 328, at 23 ("[M]any charities are loathe to link up with alcohol and cigarette companies."); Holly Hall, *Joint Ventures With Business: A Sour Deal?*, THE CHRON. OF PHILANTHROPY, Apr. 6, 1993, at 21 [hereinafter "Hall, *Joint Ventures*"] ("Many charities refuse to accept money from companies that they believe jeopardize the welfare of people or the environment . . . [M]any groups won't take donations from oil, timber, tobacco, and other industries because they are linked to environmental and public-health problems.").

difficulty finding charities to accept contributions,<sup>331</sup> and activist organizations critical of industry may have difficulty attracting corporate support.<sup>332</sup>

## B. *The Discourse of Corporate Giving*

### 1. Advertising and Marketing

Corporate managers often justify corporate transfers to charity as advertising expenses.<sup>333</sup> In particular, cause-related marketing and corporate sponsorship have emerged as two very popular ways for a corporation to use the association with a charity or charitable cause to enhance sales and improve their public image. The success of the highly-publicized American Express 1983 sponsorship of the restoration of the Statue of Liberty and Ellis Island<sup>334</sup> captured the attention of corporate managers and advertising executives. Since the American Express sponsorship, corporations have scurried to associate themselves with various charitable causes<sup>335</sup> and the marketing and advertising industries have aggressively promoted corporate

---

331. Cf. Hall, *Joint Ventures*, *supra* note 330, at 21 (discussing insincere commitments to charity). Jane Goodhall, a conservationist known for her work with chimpanzees in their natural habitats, advocates accepting such funding. Ms. Goodhall reportedly believes the existence of even a funding relationship increases the charity's ability to influence corporate policy. *Id.*

332. See Mark Feinberg, *Starving for Good PR: Corporations Force-Feed the Poor*, *BUS. & SOC'Y REV.*, Summer 1989, at 36 (discussing activists' view that corporations are giving money to promote their image and not to solve hunger). *Contra* Jennifer Moore, *Patagonia's Unorthodox Corporate Philanthropy*, *The Chron. of Philanthropy*, June 1, 1993, at 6 (discussing Patagonia's pride in "financing" activist environmental groups that other companies shun). Patagonia, the upscale outdoor clothing manufacturer, is remarkable for its support of environmental activists groups including the radical group, Earth First. Patagonia's founder explained that a major reason he started the company was to make significant contributions to charity. The founder personally gives away 50% of his annual income to charity and Patagonia transfers 1% of its gross annual sales to charity. *Id.* at 6, 12.

333. Generally, advertising is designed to produce an immediate favorable result on corporate sales and profits. See Joseph Galaskiewicz, *Corporate Contributions to Charity: Nothing More Than a Marketing Strategy?*, in *PHILANTHROPIC GIVING: STUDIES IN VARIETIES AND GOALS* *supra* note 11, at 246, 246-48 (discussing the relationship between transfers to charity and marketing). "Companies . . . usually pay more for sponsorships aimed at increasing product sales than they do for promotions to enhance their image." Holly Hall, *Putting Together Sponsorship Deals With Corporations*, *THE CHRON. OF PHILANTHROPY*, June 1, 1993, at 28 [hereinafter "Hall, *Sponsorship*"].

334. For a discussion of cause-related marketing, see *infra* notes 355-66 and accompanying text.

335. This trend among U.S. corporations has warranted comment in a British trade magazine. See, e.g., Robert Dwek, *Doing Well By Giving Generously*, *MARKETING*, July 23, 1992, at 16 (coining the term "'caring corporatism' — soft and goeey on the outside, hard as an almond on the inside").

transfers to charity as a means to increase corporate profits,<sup>336</sup> or to improve their corporate image with a targeted group of consumers.<sup>337</sup>

Corporate managers believe that they can use transfers to charity strategically to appeal to specific groups of consumers and open new markets for their products. For example, the Adolph Coors Company has long suffered from an image problem among certain consumer groups (e.g., African-Americans, gay men and lesbians, union members), due to the conservative views expressed by members of the Coors family on various social and political issues.<sup>338</sup> Coors recently launched a campaign to combat illiteracy among American women, specifically designed to make inroads among female consumers.<sup>339</sup> The scope of the campaign, entitled "Literacy. Pass It On" is ambitious and Coors has committed \$40 million to advance the cause. As a means of getting the message out, Coors plans to run ads in 750,000 copies of romance novels and print ten million brochures. The message is two-fold: learn to read and drink Coors beer.<sup>340</sup>

The eagerness of corporations to embrace charitable causes has not been lost on charitable organizations seeking to expand their funding base or make-up for cutbacks in government funding.<sup>341</sup> A case in point is the Puerto Rican Traveling Theater located in New York City.<sup>342</sup> After New York State drastically reduced its funding, the theater's director sought support from companies doing business with the Hispanic community. Her efforts were successful, particularly with Anheuser-Busch. An Anheuser-Busch executive explained its support of the theater "as a way of investing in the community

---

336. See Steven A. Meyerowitz, *Making a Mark Through Charity or Politics*, BUS. MARKETING, Mar. 1991, at 54 ("Marketing today requires that companies spend money on more than just advertising, brochures or marketing personnel.").

337. See *infra* notes 338-40 and accompanying text (describing a Coors campaign aimed at female consumers).

338. Stuart Elliott, *Coors Tries to Polish Image With Campaign For Literacy*, N.Y. TIMES, July 21, 1992, at D17.

339. One in five adult women in the United States cannot read. *Id.*

340. "[T]he Coors campaign typifies . . . a growing predilection among advertisers to try to burnish their images by adopting causes, which are promoted separately from, and in addition to, their product-selling pitches." *Id.*

341. See *infra* notes 342-43 and accompanying text (discussing the Puerto Rican Traveling Theater's reaction to a New York State funding reduction).

342. See William H. Honan, *After State Cutbacks, What One Theater is Doing to Survive*, N.Y. TIMES, July 14, 1992, at C11 (discussing the theater's efforts to survive after funding decreased).

that has made us [Anheuser-Busch] No. 1 in the Hispanic market."<sup>343</sup>

Fundraising literature advises charitable organizations to become more business-like by emphasizing how the funding will help the bottom line of the targeted corporation.<sup>344</sup> Charities in search of corporate sponsors can advertise their interests free of charge in trade publications such as *Advertising Age*, *Brandweek*, and *Promo*.<sup>345</sup> Despite this level of interest and activity, relationships between charitable organizations and corporations are subject to relatively little regulation. The current application of federal tax laws denies favorable tax treatment only to the most blatantly commercial relationships.<sup>346</sup> Often state laws governing the solicitation of charitable funds do not cover "commercial co-ventures" and are sporadically enforced.

In addition, there is no significant self-regulation. The Philanthropic Service of the Council of Better Business Bureaus adopted guidelines for "joint-venture marketing" schemes between corporations and charitable organizations.<sup>347</sup> The guidelines are designed principally to protect a charity's financial interest,<sup>348</sup> and to insure that any promotional efforts accurately describe the scope of the joint-venture.<sup>349</sup> The guidelines do not cover any of the possible ethical concerns that may arise when corporate managers, driven by "enlightened self-interest," forge partnerships of mutual advantage with charitable organizations.

343. *Id.* at C16.

344. See Smith, *supra* note 312, at 25 (referring to how charities should tone down the advocacy and stress what they can do for the corporation).

345. Imagine, if you will, the ad of the week: National charity ISO stable caring corporation for exclusive relationship . . . mutual advantage, long promotions . . . halo polishing . . . .

346. For a discussion of the deductibility of a corporate transfer to charity, see *supra* notes 73-176 and accompanying text. In addition, the donee charity is generally exempt from taxation and federal tax laws do not subject the receipt of most corporate donations to unrelated business income tax. See *infra* notes 508-11 and accompanying text.

347. Hall, *Sponsorship*, *supra* note 333, at 29.

348. For example, the guidelines require a written agreement and suggest that the agreement specify the duration of the promotion, the mode of distribution, and the resolution of any disputes. *Id.* The right to use a charity's name and logo can be quite valuable. Harry Abel, vice-president for corporate relations at the Arthritis Foundation (former national sales director for the Coca-Cola Company) explained, "[W]e think the use of our logo has a minimum \$100,000 value because we have credibility and a good reputation, both locally and nationally." *Id.* at 28. This means that a corporation would have to pay at least \$100,000 in order to advertise that it gave \$100,000 to the Arthritis Foundation.

349. *Id.*

A "community relations officer"<sup>350</sup> (i.e., a marketing executive), described this phenomenon of corporate giving when he remarked "The wave of the future isn't checkbook philanthropy . . . It's a marriage of corporate marketing and social responsibility."<sup>351</sup> Critics of this "marriage" charge that corporate giving is not real philanthropy,<sup>352</sup> and that it can impair the autonomy of charitable organizations.<sup>353</sup> Increasingly, such critics take issue with two popular practices both of which use strategic corporate giving for advertising advantage: cause-related marketing and corporate sponsorship of

350. Presumably, this is a more charitable sounding title for the "public relations officer."

351. The marketing and fundraising literature often cite this quote from the *Wall Street Journal* with obvious approval. See, e.g., PAYTON, *supra* note 168, at 72 (quoting this phrase in the context of philanthropy as a vocation). Justin Fink incorporated the quote in the following passage:

In the United States, if a "kinder, gentler nation" comes about, it is likely to be at least partly a function of concern for impending labor shortages and a need to compete more effectively with a trained work force in the new international economic order . . . Internationally, a more humane order that seeks to relieve the misery of the less developed nations . . . may reflect a recognition of the need to seek new industrial and consumer markets. *The underlying sensibility was well articulated by a corporate community relations officer* who said that "the wave of the future isn't checkbook philanthropy. It's a marriage of corporate marketing and social responsibility."

Justin Fink, *Philanthropy and the Community*, in CRITICAL ISSUES IN AMERICAN PHILANTHROPY *supra* note 320, at 133, 159 (emphasis added).

352. Dan R. Dalton & Catherine M. Daily, *The Constituents of Corporate Responsibility: Separate, But Not Separable, Interests?*, BUS. HORIZONS, July-Aug. 1991, at 74. Dalton and Daily expressed the growing disinterest in this question:

Some would be concerned that corporate behavior of this type is somehow tainted, as it is only done because it may result in good publicity, increased markets, and other presumably positive outcomes from the corporation's view. We do not count ourselves among those. That such behavior may be in the interests of the corporation does not constitute a problem. On the contrary, our point from the onset is that the interests of the corporation and those of society are not separable. That such behavior may not be altruistic or even philanthropic is not even interesting.

*Id.* at 77.

U.S. Sprint put the concluding thought another way in a television commercial when Candice Bergen said, "Is Sprint doing this to get your business? What difference does it make? We're doing it." STECKEL & SIMONS, *supra* note 7, at 55.

353. James P. Shannon, former executive director of the General Mills Foundation, rejected complaints of philanthropic "purists":

[A]n increasing number of companies are using corporate dollars, sometimes taken from advertising or marketing budgets, to underwrite their grantmaking program. This is a perfectly legitimate use of company money, even though several purists have charged that this kind of funding cannot seriously be called corporate philanthropy. . . . I know of no company that calls its grantmaking purely altruistic. Clearly the trend today is away from altruism and toward practices that tie grantmaking in some way to a company's marketing strategy.

James P. Shannon, *Successful Corporate Grantmaking: Lessons to Build On*, in THE CORPORATE CONTRIBUTIONS HANDBOOK, *supra* note 74, at 343, 353.



athletic and cultural events.<sup>354</sup>

(a) Cause-related marketing

American Express coined the term "cause-related marketing" in connection with its corporate giving promotion involving the restoration of the Statue of Liberty and Ellis Island. During the three-month campaign, American Express promised to make a "contribution" to the restoration effort each time a cardholder made a purchase with his or her American Express card or used certain other American Express services. Public response was extraordinary. In one quarter, American Express reported a rise in new card applications and a 28% increase in card usage.<sup>355</sup>

Even a quick trip to the supermarket reveals that cause-related marketing is quite popular with manufacturers,<sup>356</sup> and fundraising statistics indicate that it is on the rise. In 1990, corporations paid \$3 billion for various cause-related marketing schemes, representing a significant increase from the \$1.75 billion corporations spent on similar promotions in 1988.<sup>357</sup>

In its characteristically glowing terms, Steckel and Simons in their book *Doing Best By Doing Good*, offered the following description of cause-related marketing:

If there is such a thing as a win-win-win proposition, cause-related marketing (CRM) is it. Corporations earn money and goodwill. Nonprofits gain money and exposure. And consumers get to spend money and feel good about it. In cause-related marketing, *capitalism has actually become a phil-*

354. Such focused corporate giving "helps corporations target desirable segments of the market for their advertising while putting nonprofits in the position of converting their donors to customers of a particular business." Elizabeth T. Boris & Teresa J. Odendahl, *Ethical Issues in Fund Raising and Philanthropy*, in *CRITICAL ISSUES IN AMERICAN PHILANTHROPY*, *supra* note 320, at 188, 198.

355. STECKEL & SIMONS, *supra* note 7, at 77; Haley, *supra* note 313, at 496. In connection with the promotion, American Express 'contributed' \$1.7 million to the restoration fund. STECKEL & SIMONS, *supra* note 7, at 88; *see also* Haley, *supra* note 313, at 496 (discussing American Express's success with this promotion).

356. For example, many food manufacturers reference some charitable cause near the name of the product. *See* Haley, *supra* note 313, at 496 (discussing contributions influencing consumers). Thus, the purchase of milk or trash bags can be associated with anything from saving the rain forest, stopping domestic violence, or finding missing children. From the consumer's perspective, the purchase of milk means that at least some of the profits will be used to bring that baby home. From 1986 until 1991, Scott Paper Company transferred a portion of the proceeds from the sale of each item in its Helping Hand line to six children's charities. STECKEL & SIMONS, *supra* note 7, at 86-87.

357. Mullich, *supra* note 328, at 23.

*anthropic tool.*<sup>358</sup>

Under a typical cause-related marketing agreement, the corporate "donor" agrees to transfer a specific sum (sometimes based on the sales of a particular product) to a charitable organization. The transfer represents the payment of a licensing fee for the corporation's use of the charitable organization's name and logo in connection with the promotion. Thus, cause-related marketing is a commercial quid pro quo arrangement devoid of "charitable" intent.<sup>359</sup> This observation is not lost on marketing executives or fundraisers. For example, Patricia Caesar, president of a management and development consulting firm for charitable organizations, wrote: "Most corporate proponents of cause-related marketing argue that it is not a threat to philanthropic giving because corporations view it as a *marketing* strategy, not a channel for charitable giving."<sup>360</sup>

The repeal of the corporate provisions of section 170 will not impact on the tax treatment of such arrangements. Typically, a corporation is not entitled to a section 170 deduction for amounts transferred to charity in a cause-related marketing program because of the obvious quid pro quo nature of the exchange — the amounts transferred represent payment for the use of the charity's name and logo. The corporation is entitled to deduct such amounts under section 162 as an ordinary and necessary business expense. The donee organization is entitled to exclude any amounts paid for the use of its name and logo from its unrelated business income as a passive activity, provided that it is not required to perform any substantial services under the cause-related marketing agreement.<sup>361</sup> If the charity is required to perform substantial services, the funds received are subject to unrelated business income tax.<sup>362</sup> However, the major risk to the donee charity is not exposure to federal income tax, but rather associating with an unpopular corporate image or over-selling its own goodwill.<sup>363</sup>

---

358. STECKEL & SIMONS, *supra* note 7, at 75 (emphasis added).

359. In this way, the fee paid for the use of a charity's name and logo is the same as any other commercial transaction.

360. Patricia Caesar, *Cause-Related Marketing: The New Face of Corporate Philanthropy*, BUS. & SOC'Y REV., Fall 1986, at 15, 18.

361. See *supra* notes 225-37 and accompanying text (discussing the relationship between the section 170 corporate contribution deduction and the section 162 business expense deduction).

362. For a discussion of unrelated business income tax, see *infra* notes 386-91 and accompanying text.

363. See *supra* note 96 and accompanying text (discussing the charitable purchase of goodwill).

Corporate donors are attracted to cause-related marketing because the association with charity appeals to consumers.<sup>364</sup> From a federal tax standpoint, it makes no difference whether the corporation pays the fee to a charity for its name and logo, or it pays a fee to an advertising firm. The consumer still pays the same amount for the product. Assuming the consumer identifies with the cause, the only difference is that the consumer is left with a "warm and fuzzy" feeling concerning the product (and its manufacturer). This warm feeling is likely due to the consumer's mistaken impression that the manufacturer has chosen to forego a portion of its profit in order to benefit a charitable cause. Yet, the corporation simply substituted the "donation" for a portion of its advertising budget, and possibly gained a customer that would not have been attracted by traditional advertising.

The consumer is not entitled to deduct the portion of the purchase price paid to charity because the consumer pays full fair market value for the product.<sup>365</sup> The consumer can only claim a charitable deduction to the extent he or she overpaid for the product.<sup>366</sup> All that the corporation has done is disclose (or advertise) that a portion of the purchase price bears the cost of the use of the charity's name and logo.

#### (b) Corporate sponsorship

Although not as significant as cause-related marketing, corporate sponsorship of charity events, particularly athletic events, has received considerable attention over the last several years. In 1991,

---

364. Steckel and Simons indicated that:

According to a 1990 Roper poll, 52 percent of U.S. consumers would pay 10 percent more for a socially responsible product; 67 percent are concerned about a company's social performance when they shop. A 1990 survey by Century Research of 600 New Yorkers found that 25 percent had stopped buying the products of at least one company because [of environmental concerns].

STECKEL & SIMONS, *supra* note 7, at 48.

365. See *infra* notes 365-66 and accompanying text (discussing the effect of overpaying for a charity function).

366. Rev. Rul. 67-246, 1967-2 C.B. 104 (determining what constitutes part sale, part gift); see *supra* note 192 (explaining generally the rules governing the deductibility of admission to charity auctions, dinners and the like). Many states regulate the solicitation of charitable contributions as a form of consumer protection for unwitting donors and require charities and those soliciting for them to register with a central agency or otherwise comply with the disclosure requirements. For example, under New York law, a corporation engaged in a cause-related marketing program is considered a "commercial co-venturer" and it must disclose the exact amount of the purchase price it "donates" to charity. N.Y. [EXEC.] LAW § 172-d (McKinney 1993).

corporations paid charitable organizations \$1.1 billion in fees to sponsor charity events, including \$64 million for the right to sponsor college football bowl games.<sup>367</sup> Conceptually, corporate sponsorship differs from cause-related marketing because the corporation lends its name to a charity event instead of the charity lending its name to a corporate product. For tax purposes, the results are the same, but for different reasons.

The attention focused on corporate sponsorship was the result of a 1991 technical advice memorandum<sup>368</sup> in which the IRS classified sponsorship payments as unrelated business income to the donee charitable organization.<sup>369</sup> TAM 9147007 applied a quid pro quo analysis to determine whether the corporate sponsor made the sponsorship payment with an expectation of receiving substantial benefit in return.<sup>370</sup> The IRS concluded that "the [sponsorship] agreement clearly shows that the . . . payment is *commensurate in value with the benefits the [corporate sponsor] expects to receive* from the [o]rganization."<sup>371</sup>

In response to an intense lobbying effort by charitable organiza-

---

367. Dennis Zimmerman, *CRS Reports of Taxing Corporate Sponsorship Payments to College Bowl Games*, 92 TAX NOTES TODAY 41-18, Feb. 24, 1992, available in LEXIS, Fedtax Library, TNT File; see Haimes, *supra* note 165, at 1079 (discussing corporate sponsorship of college football bowl games and recent IRS and congressional responses).

368. Tech. Adv. Mem. 9147007 (Aug. 16, 1991). TAM 9147007 involved corporate payments to an exempt organization for the sponsorship of a college football bowl game where the charity renamed the game to reflect the corporate sponsorship. It was common knowledge that TAM 9147007 applied to the Cotton Bowl which was renamed Mobil Bowl. Haimes, *supra* note 165, at 1079 n.1 (reporting that 12 of the 18 college bowl games in 1991-92 had title sponsors, including the John Hancock Bowl). TAM 9147007 concluded that corporate payments to the charitable organization were subject to UBIT (Unrelated Business Income Tax) because the charitable organization provided a valuable good or service to the corporate sponsor. *Id.* at 14. Including such payments in unrelated business income would have reduced the value of the sponsorship payments by the top marginal unrelated business income tax rate of the sponsoring charity, taking into account the allocation of certain expenses. In addition to tax liability, a substantial amount of unrelated business income can jeopardize a charitable organization's exempt purpose, and therefore, its exempt purpose.

369. Haimes, *supra* note 165, at 1079; I.R.S. Announcement 92-15, 1992-5 I.R.B. 51 (proposed examination guidelines).

370. Haimes, *supra* note 165, at 1086-87 (discussing the application in the unrelated business income tax context of the "quid pro quo" test used to determine deductibility of transfers to charity).

371. *Id.* at 1087 (alteration in original) (citing Tech. Adv. Mem. 91-47-007, at 14 (Aug. 16, 1991))(emphasis added). The IRS rejected an argument on the part of the charitable organization that the benefit to the corporate sponsor did not require substantial effort on its part. "[T]he relative ease . . . does not overcome the fact that [the corporation received] . . . a very valuable package of benefits;" much more than "mere recognition of . . . generosity." *Id.* (quoting Tech. Adv. Mem. 91-47-007, at 14 (Aug. 16, 1991)).

tions, the IRS issued proposed regulations<sup>372</sup> in 1993 that significantly narrowed the reasoning of TAM 9147007.<sup>373</sup> The proposed regulations discontinue the quid pro quo analysis of TAM 9147007 and focus, just as the exempt community had urged, on the services required to be provided by the donee organization.<sup>374</sup> They classify the services provided as either "advertising" or "acknowledgements" and include only payments received for "advertising" in the unrelated trade or business income of the charitable donee.<sup>375</sup>

"Acknowledgements" are described as "mere recognition of spon-

372. Prop. Treas. Reg. § 1.512(a)-1(e) [1994] Stand. Fed. Tax Rep. (CCH) 22, 781A (Jan. 22, 1993); Prop. Treas. Reg. § 1.512-4 [1994] Stand. Fed. Tax Rep. (CCH) 22,793B (Jan. 22, 1993). A review of the differences between TAM 9147007 and the Proposed Regulations and the unprecedented procedure by which the Proposed Regulations were drafted reveals the influence that charitable organizations can exert over the legislative and regulatory process. This seems to question, at least with respect to exempt organizations, Professor Zelinsky's conviction that tax institutions are "less capturable" than direct funding programs. Zelinsky, *supra* note 181, at 1167, 1194.

373. Prior to the issuance of the Proposed Regulations, the IRS released proposed examination guidelines to implement its ruling in TAM 9147007. I.R.S. Announcement 92-15, 1992-5 I.R.B. 51; Haimes, *supra* note 165, at 1102. The proposed examination guidelines were published for public comment in an apparent departure from standard IRS procedure. *Id.* at 1102 n.125. The guidelines provoked a swift and negative reaction from the exempt community and its supporters in Congress. The IRS held three days of public hearings and it received over 300 comments. Outraged members of Congress introduced several bills expressly excluding corporate sponsorship payments from unrelated business income. Elizabeth A. Purcell, assistant branch chief in the IRS Office of Associate Chief Counsel (Employee Benefits and Exempt Organizations) referred to the heated public comment as "a tremendous outpouring of ideas and comments" while speaking at the 10th Annual Nonprofit Organizations Institute at the University of Texas School of Law. Marlis L. Carson, *IRS Representative Discusses Evolution of Corporate Sponsorship Regs.*, 93 TAX NOTES TODAY 26-17, Feb. 4, 1993, available in LEXIS, Fedtax Library, TNT File.

374. This is despite the strong doctrinal basis for the quid pro quo approach (i.e., for UBIT purposes, incorporating a sponsor into a charity event seems less passive than licensing the charity's name and logo, and therefore, outside of the scope of the policy supporting the exclusion from UBIT for certain passive activities). See Lee A. Sheppard, *The Goldberg Variations, or Giving Away the Store*, 93 TAX NOTES TODAY 31-17, Feb. 9, 1993, available in LEXIS, Fedtax Library, TNT File (criticizing the about-face of the IRS); accord Paul Streckfus, *IRS' Pre-Inaugural Gift for Charities*, 93 TAX NOTES TODAY 17-11, Jan. 25, 1993, available in LEXIS, Fedtax Library, TNT File. Russlyn Guritz, an IRS projects specialist speaking at the 10th Annual Representing and Managing Tax-Exempt Organizations conference sponsored by Georgetown University Law Center, described the proposed regulations as "a great example of how well government can work when it works in partnership with those that it must govern." Marlis L. Carson, *Guritz Praises Proposed Corporate Sponsorship Regs.*, 93 TAX NOTES TODAY 96-6, May 4, 1993, available in LEXIS, Fedtax Library, TNT File.

375. The distinction is based loosely upon the separation of the corporate sponsor from its products or services. The proposed regulations borrow heavily from the Federal Communications rules regarding when a public television or radio station is permitted to acknowledge a sponsor in return for a payment. Prop. Treas. Reg. § 1.512(a)-1 [1994] Stand. Fed. Tax Rep. (CCH) 22,781A (Jan. 22, 1993); Prop. Treas. Reg. § 1.513-4 [1994] Stand. Fed. Tax Rep. (CCH) 22,793B (Jan. 22, 1993).

sorship payments”<sup>376</sup> and may include:

sponsor logos and slogans that do not contain comparative or qualitative descriptions of the sponsor’s products, services, facilities or company; sponsor locations and telephone numbers, value-neutral descriptions, including displays or visual depictions, of a sponsor’s product-line or services; and sponsor brand or trade names and product or service listings.<sup>377</sup>

The examples set forth in the proposed regulation illustrate that the definition of “acknowledgements” is quite expansive.<sup>378</sup> Moreover, it encompasses many activities commonly considered advertising.<sup>379</sup>

“Advertising” involves messages that incorporate a “call to action” or an “inducement to buy,”<sup>380</sup> but its scope is very narrow. For example, the charity or the sponsor can sell or distribute a sponsor’s product to the general public at a sponsored event.<sup>381</sup> Such distribution is not considered an “inducement to buy.”<sup>382</sup> Although the proposed regulations<sup>383</sup> purport to establish a bright-line test to distin-

---

376. Prop. Treas. Reg. § 1.513-4(c)(1) [1994] Stand. Fed. Tax Rep. (CCH) 22,793B (Jan. 22, 1993).

377. *Id.* The proposed regulations do not apply to advertising in periodicals or to the activities of organizations exempt from tax under a different section than 501(c)(3). I.R.C. § 501(c)(3) (West 1994).

378. Example 4 illustrates just how far a charitable donee’s activities can go without being considered advertising. The example concludes that the donee’s activities in connection with the sponsorship of a college football bowl game are acknowledgements. Under the sponsorship agreement, the charity agrees to change the name of the game to include the name of the exclusive corporate sponsor. In addition, “the corporation’s name and special logo will appear on players’ helmets and uniforms, on the scoreboard and stadium signs, on the playing field, on cups used to serve drinks at the game, and on all related printed material.” The contract further specifies that “television cameras will focus on the corporation’s name and logo on the field at certain intervals during the game.” Prop. Treas. Reg. § 1.513-4(g), example 4, [1994] Stand. Fed. Tax Rep. (CCH) 22,793B (Jan. 22, 1993).

379. Lee Sheppard correctly pointed out that although the regulatory definition of advertising is very broad, the exceptions set forth under the term “acknowledgements” render the first term meaningless. He aptly termed this “the exception that eats the rule.” Sheppard, *supra* note 372. Tax Notes Today reported that Marcus S. Owens, director of the IRS Exempt Organization Technical Division acknowledged that the proposed regulations permit activity usually characterized as advertising. Marlis L. Carson, *Corporate Sponsorship Regs Provide “Clear Line” for IRS, Charities, Says Owens*, 93 TAX NOTES TODAY 87-16, Apr. 21, 1993, available in LEXIS, Fedtax Library, TNT File.

380. Prop. Treas. Reg. § 1.513-4(c)(2), [1994] Stand. Fed. Tax Rep. (CCH) 22,793B (Jan. 22, 1993).

381. *Id.*

382. The IRS acknowledges that it cannot justify this exclusion on the basis of the substance. Instead, it relies on “the principle of administrative simplicity”, admitting that “the lines drawn between activities constituting advertising and acknowledgements may not relate to the substance of the activities.” Prop. Treas. Reg. § 1.512(a)-1, 58 Fed. Reg. 5687 (1993).

383. The proposed regulations under I.R.C. § 512 contain some examples of advertising activities to illustrate the very favorable rule regarding the allocation of expenses between related and unrelated activities. Prop. Treas. Reg. § 1.512(a)-1(e), examples 2-4, [1994] Stand. Fed. Tax

guish between "advertising" and "acknowledgements," they include numerous examples of acknowledgements and only two examples of advertising activities.<sup>384</sup> The two examples are blatantly commercial and as such provide little guidance in close cases.<sup>385</sup>

The effect of the proposed regulations is to exclude from Unrelated Business Income Tax (UBIT) all but the most patently commercial sponsorship agreements under which the charity agrees to participate actively in promotion of a sponsor's product or service. Hence, charities can easily avoid tax on sponsorship payments and corporations can deduct the cost of the payment. Excluding most sponsorship payments from UBIT ignores the existence of the "halo effect" and the fact that many fundraisers actively trade on the charitable goodwill of their organizations. It also ignores the case law recognizing that corporate donors receive goodwill advertising simply by the acknowledgement of corporate giving, and that such advertising constitutes a financial benefit for purposes of section 162 and 170.<sup>386</sup>

The corporate sponsors of college bowl games receive a substantial benefit from the sponsorship. In fact, corporate sponsors may receive benefits far in excess of the sponsorship payment. John Hancock estimated that it received \$5.1 million of advertising services in exchange for its 1990 payment of \$1.6 million to be associated with the college bowl game that now bears its name.<sup>387</sup> As discussed in Part I, Section A, this "more bang for the buck" feature of corporate giving is the result of the "halo effect" which surrounds a corporate sponsor (and its products or services) with the charity's goodwill.

Given the similarity between advertising and sponsorship expenditures, the potential competitive advantage provided by the tax ex-

---

Rep. (CCH) 22,781A (Jan. 22, 1993).

384. See Prop. Treas. Reg. § 1.513-4(g), examples 7, 8, [1994] Stand. Fed. Tax Rep. (CCH) 22,793B (Jan. 22, 1993).

385. For example, the Treasury Department believed that it was necessary to warn charitable organizations that the following message crossed the line and constituted advertising: "This program has been underwritten by the Record Shop, where you can find all of your great hit music. The Record Shop is located at 123 Main Street. Give them a call today at 555-1234. This station is proud to have the Record Shop as a sponsor." Prop. Treas. Reg. § 1.513-4(g), example 7, [1994] Stand. Fed. Tax Rep. (CCH) 22,793B (Jan. 22, 1993).

386. See *supra* notes 225-39 and accompanying text (discussing the relationship between the corporate contribution deduction and the section 162 business expense deduction).

387. Haimes, *supra* note 165, at 1090 n.59 (citing Dennis Zimmerman, *Corporate Title Sponsorship Payments to Nonprofit College Football Bowl Games: Should They Be Taxed?*, 92 TAX NOTES TODAY 41-18, Feb. 11, 1992, available in LEXIS, Fedtax Library, TNT File).

emption strongly suggests that sponsorship payments should be included in the unrelated business income of the charity. The argument for inclusion goes to the heart of the rationale for UBIT — to prevent unfair competition by subsidizing the commercial activities of exempt organizations.

Unlike commercial advertising agencies, the charity operates free of federal income tax on its net receipts.<sup>388</sup> The exemption of sponsorship payments from UBIT provides “subsidized advertising rates for sponsoring corporations”<sup>389</sup> and John Hancock can receive advertising services far in excess of the sponsorship fee. The social good provided by the subsidy is arguably insignificant. The subsidy provides an incentive for corporate sponsorship which may reduce the cost of admission to the event, thereby providing a benefit for the consumer — the sports fan.<sup>390</sup> Accordingly, the exclusion of sponsorship payments from UBIT subsidizes corporate advertising and the price of tickets to charity events at the expense of millions of dollars of foregone federal revenue.<sup>391</sup>

## 2. *Goodwill and Public Relations*

One-step removed from cause-related marketing and sponsorship promotions are corporate contributions designed to advance the long-term interests of the corporation and generally enhance corpo-

---

388. This is subject to the possible application of UBIT on income from a trade or business regularly carried on that is not substantially related to its exempt purpose. *Id.* at 1089. Even where the activity is not exempt, tax exempt organizations are able to achieve “‘economies of scope by engaging in a business activity that, while not in itself an exempt function, . . . can be undertaken at lower cost because it exhibits cost complementarities with the non-profit’s exempt functions.’” *Id.* at 1112 n.179 (quoting Henry B. Hansmann, *Unfair Competition and the Unrelated Business Income Tax*, 75 VA. L. REV. 605, 626-27 (1989)).

389. *Id.* at 1111 (quoting Zimmerman, *supra* note 367, at 2).

390. A Library of Congress Congressional Service Report expressed the issue in terms of balancing competing policy interests requiring the comparison of “the detrimental effects of arguably unfair competition (subsidized advertising rates for sponsoring corporations) and the sacrifice of Federal revenue against the potential loss of social benefits.” *Id.* (citing Zimmerman, *supra* note 367, at 8). The Report, adopting a public goods analysis, identified the benefits as follows:

[1] lower ticket prices and/or an increased quantity of college football bowl games (which would benefit primarily consumers of college football bowl games); [2] lower advertising rates or, phrased differently, smaller sponsorship payments (which would benefit primarily corporate sponsors); or [3] increased funding for universities (whose primary beneficiaries might include several different activities and groups).

*Id.* at 1114 (footnote omitted) (quoting Zimmerman, *supra* note 367, at 10).

391. *Id.* at 1090, 1111 (reporting a 1991 estimate of \$281 million in lost federal revenue as a result of corporate sponsorship, \$5 million of which was attributable to college bowl games).



rate goodwill.<sup>392</sup> These types of corporate transfers are comparable to public relations expenditures.<sup>393</sup> For example, Robert Haas, chief executive officer of Levi Strauss & Company, speaking of his company's commitment to corporate giving, explained how a corporation is dependent on community goodwill:

[H]owever small or large our enterprise, we cannot isolate our business from the society around us. Nor can we function without its goodwill. We may need the goodwill of a neighborhood to enlarge a corner store. We may need well-funded institutions of higher learning to turn out the skilled technical employees we require. We may need adequate community health care to curb absenteeism in our plants. Or we may need fair tax treatment for an industry to be able to compete in the world economy.<sup>394</sup>

The chairman and chief executive officer of Monsanto, Richard Mahoney, expressed similar views emphasizing community involvement<sup>395</sup> and the fact that his business "cares."

We earn our right to operate by doing the right thing — whether the arena is the competitive marketplace, Wall Street, the workplace or the communities in which we do business . . . Doing the right thing in our communities means accepting our responsibility to be a good citizen — a reliable neighbor who works to improve educational, cultural and civic vitality, while conducting our business in a responsible, forthright manner. We care about and

392. In a slightly different context, the Treasury Department subscribed to the view that a corporate transfer to charity constitutes "a purchase of goodwill." In 1991, the Treasury Department issued proposed regulations under section 861 concerning the allocation of deductions to foreign source income. The Proposed 861 Regulations described a corporate transfer to charity as a "purchase of goodwill" and reasoned that a contribution for use in a foreign country represented a corporate purchase of goodwill in that country. Accordingly, the proposed regulations required the corporate donor to allocate any deductions for such contributions against foreign source income. The practical effect was to deny U.S. corporations with foreign source income any tax benefit for foreign contributions because of excess foreign tax credits. This ignited fierce criticism from the charitable community. As a result, the Treasury Department has been forced to rethink the allocation requirement. It has not, however, discarded its premise that a corporate transfer to charity represents a purchase of goodwill. See Ruth A. Flynn, Comment, *The Impact of U.S. Tax Laws on the Future of Debt-for-Nature Swaps*, 7 TEMP. INT'L & COMP. L.J. 319, 337-42 (1993) (discussing Proposed Regulation 861).

393. EELLS, *supra* note 74, at 172; see HALL, *supra* note 97, at 108 (stating that "corporations today view contributions programs primarily as . . . public-relations devices").

394. James A. Joseph, *The Corporate Stake in Community Involvement: Has Business Lost its Social Conscience?*, in THE CORPORATE CONTRIBUTIONS HANDBOOK *supra* note 74, at 3, 4-5.

395. Generating goodwill in the community in which a corporation does business is considered a desirable way to reduce costs. See *supra* note 308 (discussing ways in which a company can reduce costs by contributing to the community); Alex J. Plinio & Joane B. Scanlan, *Total Resource Leveraging and Matching: Expanding the Concept of Corporate Community Involvement*, in THE CORPORATE CONTRIBUTIONS HANDBOOK, *supra* note 74, at 283-84 (noting that corporations often ignore the ability to get "substantial services and assistance from the community to assist the corporation").

share in the quality of life in every community where we do business.<sup>396</sup>

Both managers and fundraisers are aware of the ability of corporate giving to generate corporate goodwill through favorable public relations. It is not surprising that both groups seek the positive effects of such giving.<sup>397</sup> For example, the title of an article in a banking industry trade magazine reads: *Getting Your Dollar's Worth from Donations*.<sup>398</sup> The article advises bankers how to get the most mileage out of their charitable dollars. For starters, the article tells the donative banker to "[s]pread donations out over the year and have each recipient agree to do a press release on the contribution received."<sup>399</sup> In addition, the banker should "give things", not just money.<sup>400</sup> After all, "[a] newspaper story about a donation of a new respirator for an ambulance will attract much more attention if it appears with a photograph of the bank's CEO helping paramedics lift it on board."<sup>401</sup>

Corporate contributions to public television or radio are one of the more visible examples of corporate giving.<sup>402</sup> Corporate managers and fundraisers cannot say enough good things about the public relations and corporate goodwill benefits associated with supporting public television.<sup>403</sup> Corporate support for public television is so commonplace that the comment to the A.L.I. *Principles of Corporate Governance*<sup>404</sup> specifically mentions corporate contributions to public television.<sup>405</sup>

396. James A. Joseph, *The Corporate Stake in Community Involvement: Has Business Lost its Social Conscience?*, in THE CORPORATE CONTRIBUTIONS HANDBOOK *supra* note 74, at 3, 5.

397. See STECKEL & SIMONS, *supra* note 7 (discussing how corporate managers can benefit their corporation and community through corporate contributions).

398. Charlotte LeGates, *Getting Your Dollar's Worth From Donations*, BANKERS MONTHLY, Feb. 1992, at 34.

399. *Id.*

400. *Id.* "[C]ustomers will remember the local news program showing their bank's CEO and the community's fire chief trying on the newly donated flameproof suits [better than they will remember the presentation of a \$300 check]." *Id.*

401. *Id.*

402. See Green, *supra* note 60, at 239, 255-57 (describing contributions by major corporations to public television and other socially beneficial programs using the mass media).

403. See, e.g., KOCH, *supra* note 163, at 264 ("The corporate public relations benefits are more immediate and varied than from support of just about any other nonprofit entity or service.").

404. PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS & RECOMMENDATIONS § 2.01 comment i (Tent. Draft No. 2, 1984) [hereinafter A.L.I. PRINCIPLES].

405. Davis, *supra* note 119, at 66 (referring to A.L.I. PRINCIPLES, *supra* note 404, § 2.01 comment i, at 39). The comment further recognizes that support for public television is the functional equivalent of commercial advertising. The comment states that "'a donation to public television may be made for reasons comparable to those for sponsoring a commercial.'" *Id.* (quoting A.L.I.

Managers and fundraisers also describe corporate giving to the arts as public relations, particularly where the charitable purpose of the donee charity is seemingly remote from the business goals of the corporate donor. Such giving reaches elite audiences and has the added bonus of fostering an air of respectability and sophistication.

It [corporate giving to the arts] can provide a company with extensive publicity and advertising, a brighter public reputation, and an improved corporate image. It can build better customer relations, a readier acceptance of company products, and a superior appraisal of their quality. Promotion of the arts can improve the morale of employees and help attract qualified personnel.<sup>406</sup>

A corporate contribution to public broadcasting or a community fund for an arts program qualifies as a charitable contribution under section 170,<sup>407</sup> provided the corporation makes the expenditure without the expectation of receiving a commensurate benefit in return (other than the intangible goodwill created by the contribution and its acknowledgement).<sup>408</sup> If the expenditure does not qualify under section 170, it may constitute a capital expenditure, not immediately deductible under section 162.<sup>409</sup>

From the standpoint of the charitable recipient, the transfer is not included in unrelated business income. The consumer is exposed to the corporate donor's name and its charitable proclivities. Compared to cause-related-marketing and corporate sponsorship, it is less likely that the consumer will associate the charitable cause with a specific product or services.

---

PRINCIPLES, *supra* note 404, section 2.01 comment i, at 39). This distinction may be due in part to the FCC regulation of the acknowledgement of corporate giving within the context of public broadcasting. *Id.* The comment also acknowledges other uses of corporate giving: "[A] contribution to local Red Cross or Community Chest activities may be made for reasons of employee well-being and morale." *Id.* (quoting A.L.I. PRINCIPLES, *supra* note 404, § 2.01 comment i, at 39).

406. KOCH, *supra* note 163, at 240 (quoting David Rockefeller, president of the Chase Manhattan Bank, in an address given by him in 1966).

407. I.R.C. § 170 (West 1994); see *supra* notes 182-87 and accompanying text (discussing the relevant portions of section 170).

408. The fact that the section 170 quid pro quo analysis does not consider the goodwill intentionally created and purchased by the corporate transfer to charity is inconsistent with the *Hernandez* decision where the expectation of an intangible religious benefit satisfied the quid pro quo requirement. See *Hernandez v. Commissioner*, 490 U.S. 680 (1989) (finding that the expectation of an intangible religious benefit satisfied the quid pro quo requirement). A corporate public relations expenditure that is paid to a commercial agency is made with the expectation of receiving a commensurate benefit in return. There is no rational basis for treating a purchase of goodwill from a charitable organization differently.

409. See *supra* notes 225-39 and accompanying text (discussing section 162).

### 3. *Investment in the Future: Future Markets and Future Employees*

Marketing literature discusses the "strategic" use of corporate donations to secure future employees for the corporation and future markets for its products or services. Commentators sometimes express corporate giving as an investment in the future and draw a strict analogy between corporate giving and corporate research and development expenses.<sup>410</sup> Commentators advocating increased professionalism in corporate giving stress that just like other corporate projects, corporate giving requires long-term planning and organization: "Each corporation should develop its own strategy for corporate giving and community involvement in the same way that it develops an acquisitions strategy or product development strategy."<sup>411</sup>

An immediate way for a corporation to expand its market is to gain access to the membership, patrons, supporters, or donors of a popular local charity. Fundraisers are aware of this benefit and they urge that a charity should include detailed information about its constituency (e.g. gender, age, income level) with its appeal for corporate funds.<sup>412</sup> For example, the development staff at the Franklin Institute Science Museum (the "Institute") in Philadelphia analyzed the demographics of its visitors and then used this information to make the museum more attractive to corporate sponsors.<sup>413</sup> The Institute's Director of Development, Donald Smith, noted that the Institute had one million visitors annually and boasted in an appeal for corporate sponsors that "no one else in Philly [sic] can deliver the audience that we can."<sup>414</sup> Thus, a transfer to the Institute provides a corporate sponsor not only benefits from the traditional press releases, but it also gains very specific information about the over one million people who will view the acknowledgement of the corporation's generosity.

---

410. For example, Dalton and Daley argued that corporate giving is necessary to produce new markets and a new labor force and that it is just as essential to the success of a business as research and development efforts. "They [transfers to charity] all have an element of risk; they are all relatively long-term (advertising to a lesser extent) in impact. And, they are all absolutely fundamental to the future of the corporation and *all of its constituencies*." Dalton & Daily, *supra* note 352, at 77.

411. Koch, *supra* note 163, at 12.

412. Hall, *Sponsorship*, *supra* note 333, at 28. "Companies are particularly impressed when a non-profit group provides demographic information [with a proposal] compiled by an outside company." *Id.*

413. *Id.* at 27.

414. *Id.*

The emphasis on future markets and future employees was the central theme of President Bush's education reform initiative, America 2000. In 1991, Mr. Bush, the self-proclaimed "Education President,"<sup>415</sup> unveiled his comprehensive plan to revitalize the education system in the United States — America 2000,<sup>416</sup> which was heavily dependent upon corporate funding. Central to the plan was the creation of an independent nongovernmental nonprofit organization called the New American Schools Development Corporation ("NASDC").<sup>417</sup> President Bush characterized the NASDC as a private sector research and development ("R & D") institute that would use the results of its "R & D" to establish 535 new schools (at least one in every Congressional District). NASDC was organized and operated as a corporation exempt from federal income tax under section 501(c)(3) and qualified to receive tax-deductible contributions.

From its inception, Mr. Bush expected NASDC to raise its own funds in the form of private charitable contributions. Mr. Bush estimated that initially NASDC would raise somewhere between \$150 million and \$200 million from private industry.<sup>418</sup> President Bush stressed:

There's a special place in inventing the new American school for the corporate community, for business, and labor, and I invite you to work with us

---

415. On October 14, 1987, then-Vice President Bush announced in a campaign speech to Republican supporters in Dearborn, Michigan, "I'd like to be known as the education president" because "education is going to be the top priority for me." *Bush Puts Education as Top Priority*, UPI, Oct. 14, 1987, available in LEXIS, News Library, ARCNWS File. He reiterated this desire in a debate in New Hampshire during the Presidential Republican primary race. Vice President Bush remarked, "My vision? I want to be the education president." Frank Clifford, *Conservatives Attack Bush, Dole in Lively N.H. Debate*, L.A. TIMES, Jan. 17, 1988, at A1.

416. In President Bush's 1990 State of the Union Address, he listed the six goals for American education developed by the National Governors Association Task Force on Education. *Bush's State of the Union Address*, UPI, Jan. 31, 1990, available in LEXIS, News Library, ARCNWS File. President Bush, however, did not propose a funding source or any cost estimate. *Id.* President Bush did not offer a solution to the funding riddle (i.e., how to increase services without increasing the demand on tax revenues) until the following year.

417. Bush announced the creation of the New American Schools Development Corporation at an address on education before invited congressmen and business leaders. *President Bush Address on Education to Congressmen, Business and Community Leaders*, Federal News Service, Apr. 18, 1991, available in LEXIS, News Library, ARCNWS File [hereinafter *President Bush Address on Education*]. Bush restated the six goals for American education that he announced during his State of the Union address on January 31, 1990. *Id.*

418. *Id.* This is an oversimplification. As discussed in Part II, Section C, from a tax-expenditure standpoint, a portion of every corporate dollar transferred to charity represents foregone federal income tax revenue. See *infra* notes 445-87 and accompanying text (discussing agenda and corporate giving). In addition, Congress did appropriate start-up funds for the organization.

not simply to transform our schools but to transform every American adult into a student. . . . The corporate community can take the lead by creating a voluntary private system of world class standards for the work place.<sup>419</sup>

Mr. Bush's message was clear. It was time for private industry to hear the call and recognize that education was a key component to economic recovery because it insured a never-ending supply of educated workers and, perhaps more importantly, educated consumers. The promise of the high technology marketplace of the future will require highly-skilled workers. Educated consumers are essential to create a demand for the high technology products of the future.

Traditionally, a significant portion of corporate giving has been directed toward education.<sup>420</sup> The corporate action approved by the New Jersey Supreme Court in *A.P. Smith Manufacturing Company v. Barlow*<sup>421</sup> was a contribution to Princeton University. The court not only approved the contribution, it remarked that a corporation had a "solemn duty" to support higher education:

[T]he contribution here in question is towards a cause which is intimately tied into the preservation of American business and the American way of life. Such giving may be called an incidental power, but when it is considered in its essential character, it may well be regarded as a major, though unwritten, corporate power. It is even more than that. In the court's view of the case it amounts to a solemn duty.<sup>422</sup>

In addition to direct financial assistance, corporate support for education includes the donation of products,<sup>423</sup> research funding of university laboratories,<sup>424</sup> scholarship support for the children of em-

---

419. *President Bush Address on Education, supra* note 417.

420. The bulk of contemporary corporate giving is directed towards higher education. Recent trends indicate a growing interest in secondary and primary education. Fundraisers estimate that corporate giving to education has increased by 11% in recent years. An example of this long connection between business and education is General Electric's "matching gift" program. In 1955, General Electric instituted the first "matching gift" program for employee contributions to educational institutions. The rationale for the program was to permit employees to share in corporate giving decisionmaking, support where the employees went to school, and to provide a strong incentive for employees to participate. *See supra* note 268 (discussing how many corporations followed General Electric's lead by initiating their own "matching gift" programs).

421. 97 A.2d 186 (1953), *aff'd* 98 A.2d 581 (1953).

422. *A.P. Smith Mfg. Co.*, 97 A.2d at 192.

423. Joseph Galaskiewicz, *Corporate Contributions to Charity: Nothing More than a Marketing Strategy?*, in *PHILANTHROPIC GIVING: STUDIES IN VARIETIES AND GOALS, supra* note 11, at 246, 247 (describing direct benefit from donation of computer hardware by IBM and Apple to establish a user base).

424. Katherine Bouton, *Academic Research and Big Business: A Delicate Balance*, N.Y. TIMES, Sept. 11, 1983, § 6, at 62.

ployees,<sup>425</sup> and exclusive product relationships.<sup>426</sup>

A popular way for corporations to pursue future markets is to donate their products to a charitable organization for use by its members, volunteers, employees, or, in the case of educational institutions, its students.<sup>427</sup> A fundraising executive writes:

In many ways, gifts-in-kind is a better way for a corporation to donate to charity. First, the company knows that its donation —its products — will be used for the purpose intended. Second, the product has “built-in goodwill.” Every time a recipient uses that product, he sees the logo or recognizes the company. It is like giving away a little part of yourself. And finally, these products, once tested and used by the nonprofit and its clients or students, can often expand a market base. A student who uses a donated computer and likes it may later decide to buy one for home.<sup>428</sup>

The executive concludes: “From a business perspective, it is a smart thing to do; from a humanitarian perspective, it is the right thing to do.”<sup>429</sup>

Under section 170(e), the contribution by corporations of certain products to certain charities results in more favorable tax treatment than simply liquidating or dumping the products.<sup>430</sup> The opportunities presented by section 170(e) have led to the creation of organizations designed to match manufacturers with qualified charities.<sup>431</sup> Financial advisers, always quick to exploit a “tax break,” vigorously advocate section 170(e) gifts. One such adviser wrote: “Excessive buildup of inventory, which ties up cash, can be a real risk in an economic downturn. Here’s a solution: donate your excess inventory

425. See Jim Jones, *Aftermath of the Exodus*, U.S. NEWS & WORLD REPORT, May 1, 1989, at 49, 50 (noting that South African business owners are improving their work force, allowing employees’ children to benefit from corporate funding to schools).

426. A recent example of an exclusive product relationship is the 1992 agreement between Penn State University and Pepsi. Under the 10-year contract, Penn State agreed to sell only Pepsi soft drinks on its 21 campuses, and Pepsi agreed to transfer \$14 million for scholarship funds and a new athletic stadium. *Cola Cum Laude*, TIME, June 22, 1992, at 30.

427. See *Singer Co. v. United States*, 449 F.2d 413 (Cl. Ct. 1971) (recognizing in certain instances that the donation of sewing machines to schools to secure futures sales constitutes the expectation of a commensurate benefit).

428. Gary C. Smith, *Corporations Turning Charity Into Cash*, BUS. & SOC’Y REV., Spring 1989, at 42, 45.

429. *Id.*

430. See *supra* notes 242-51 and accompanying text (discussing the tax treatment a corporation receives under section 170 when it transfers either appreciated property or inventory property to charity).

431. The text of an advertisement for a company identified as “EAL” in *Time* magazine reads: “Turn your excess inventory into a substantial tax break and help send needy kids to college as well . . . [L]earn how donating your slow moving inventory can mean a generous tax write-off for your company.” TIME, June 22, 1992, at 17.

. . . under Section 170(e)(3). . . ."<sup>432</sup>

The needs of the donee charity are sometimes overlooked in the rush to donate (i.e., unload) slow moving (i.e., obsolete) excess inventory. For example, in *Starving for Good PR: Corporations Force-Feed the Poor*, Feinberg states that the food industry uses food banks "as dumping grounds for unusable, unsalable food."<sup>433</sup> The corporation is entitled to the deduction regardless of the suitability of the property transferred.<sup>434</sup>

#### 4. *The Delicate Balance Required*

A consistent theme throughout the marketing and fundraising literature is the need for corporate philanthropy to achieve a "balance" between economic self-interest and altruistic social responsibility.<sup>435</sup> Eells expressed the desire to achieve this balance as the "dilemma" presented by corporate giving.

The basic justification for corporate giving, then, is a philosophy of enlightened self-interest. For if a company merely engages in "charity *qua* charity," it reflects an altruism more laudable than defensible as an exercise of corporate authority. Yet, if its gifts fail to serve the broader interests of mankind, they cease to qualify as philanthropy, with implications that will concern the tax collector. Corporation philanthropy, in short, must get in between the horns of a rather difficult dilemma.<sup>436</sup>

To the extent that corporate giving achieves the delicate balance between self-interest and altruism, its proponents can justify the practice as entirely consistent with a profit maximization model of the corporation while capitalizing on the "halo effect" which inures to socially responsible corporations. This suggests that the criticism of corporate giving from the profit maximization camp<sup>437</sup> has influ-

432. Jill A. Fraser, *Charitable Donations With a Big Payoff*, Inc., May 1991, at 99.

433. Feinberg, *supra* note 332, at 38 (noting the donation of "microwave browning spray and crumbled candy bar innards").

434. The substantiation rules require the charitable donee to acknowledge receipt of the property, but the donee is not required to attest to the fair market value of the property received. Treas. Reg. § 1.170-13 (1994).

435. A fundraiser remarked, "Some corporate marketing executives complain that non-profits waste their time by talking about charitable programs instead of how they could help the company reach new customers. . . . 'We're talking about cold advertising and marketing people who couldn't care less about your cause.'" Hall, *Sponsorship supra* note 333, at 27 (quoting Don Smith, director of development at the Franklin Institute Science Museum in Philadelphia).

436. EELLS, *supra* note 74, at 7.

437. See, e.g., Johnson, *supra* note 167, at 14 ("There is a very real social responsibility, and that is to make as much money as they can subject to staying within the law and within the appropriate ethical standard.").



enced the conception and expression of corporate philanthropy.<sup>438</sup> As explained below, it is difficult to achieve the necessary balance.

Reports from the field, however, suggest that it is easier to accommodate these two seemingly divergent goals in theory than in practice. Individuals working for charitable organizations, report that "dual agenda giving" can create tension. At a recent non-profit conference, a fundraising consultant warned exempt organizations to beware of corporations that offer "insincere commitments" and try to take advantage of a charity's goodwill and lack of business experience.<sup>439</sup>

Professor Karen Paul researched corporate philanthropy and its impact on South Africa in light of the Sullivan Principles.<sup>440</sup> Her observations vividly underscore the complexity inherent in corporate grantmaking.

The corporate officers engaged in the philanthropic effort seem to me to be persons of integrity who desire to do good with their efforts. But they embrace a number of conflicting expectations. They want to do good for those people who are the targets of projects supported, but they also want to do good for the corporation. They want to support authentic community lead-

438. To accommodate this "dual agenda giving", Payton proposed the creation of "a revised paradigm [to] identify a new balance point between altruism and self-interest and define parameters for corporate giving that tap and blend the best of both motivations." PAYTON, *supra* note 168, at 201. Professors Harvey and McCrohan described a similar conception of "dual-agenda giving":

Dual-agenda giving is the concept of requiring a fit between corporate objectives and the objectives of the philanthropic organizations they support. This type of giving is based on a market-driven approach to company goals by generating support from a target customer base. Whether a cause is supported is determined by the alignment of corporate and customer needs.

Harvey & McCrohan, *supra* note 320, at 47.

439. Hall, *Joint Ventures*, *supra* note 330, at 21 (quoting Lesa Ukman, president of International Events Group).

440. In 1977, an African-American Baptist minister from Philadelphia and a member of the Board of directors of General Motors Corporation wrote guidelines that sought to improve the working standards of non-white employees of American firms in South Africa. These guidelines became known as the "Sullivan Principles", and when companies agreed to abide by them they promised to:

- 1) Bar racial discrimination in all company eating, toilet and work facilities;
- 2) Provide equal and fair employment practices for all employees;
- 3) Ensure equal pay for equal and comparable work;
- 4) Develop training programs to prepare non-white employees for supervisory, administrative and technical jobs;
- 5) Increase the number of non-whites in management; and
- 6) Improve the quality of the employees' lives outside the workplace by a variety of means, including the development of good schools and better housing.

Donald W. Gallagher, *The Sullivan Principles: A Code for Companies in South Africa Not an Anti-Disinvestment Movement*, UPI, Sept. 9, 1985, available in LEXIS, News Library, ARCNWS File.

ers, but they also want to support individuals who come from the community but who will cut a dashing figure for visiting corporate officials and in the eyes of the media. They want projects to make a difference in the lives of blacks, but they also want projects that would serve corporate interests.<sup>441</sup>

Critics of corporate giving have identified a similar conflict in the case of U.S. hunger relief.<sup>442</sup> Recognizing that hunger relief is a popular cause for corporations, Feinberg asserted that corporate donors fund short-term emergency food relief programs, but shy-away from long-term solutions.<sup>443</sup> Hunger activists explain that corporate giving is not "motivated by a desire to solve the problem of hunger. . . . [Rather, the purpose is] to promote a shining corporate image."<sup>444</sup>

### C. *A Final Caveat — To Look Beyond The Stated*

In large part, the conclusions set forth in this article are based on the construction of corporate giving as expressed in the marketing and fundraising literature. These conclusions are incomplete without an acknowledgement that they are based on the statements of individuals actively engaged in the practice of corporate giving, many of whom may have a vested interest in the continuation and institutionalization of the practice.<sup>445</sup> Clearly, statements by proponents of corporate giving may be inherently self-serving, and may carry unspoken meanings with wide-reaching social, political, and economic impact.<sup>446</sup>

#### 1. *Dual Agenda or Hidden Agenda Giving*

The contemporary discourse of corporate charitable giving at-

441. Karen Paul, *Corporate Philanthropy*, Soc'y, Sept.-Oct. 1990, at 15, 16.

442. See Feinberg, *supra* note 332 (criticizing corporate giving as building up short-term relief for hunger, but ignoring long-term results).

443. *Id.* at 37-38. Feinberg concludes: "Emergency food relief is appropriate for Third World countries where food is scarce. But emergency relief is inappropriate here because food is abundant. The problem underlying hunger is not scarcity, but poverty." *Id.* at 38.

444. *Id.* at 36.

445. One thing that is striking about the discussion is that it is phrased in a business vocabulary which seems somehow mismatched with philanthropic endeavors. For example, grants are termed "investments" and corporate grantmakers are said to "manage" "portfolios" of grants. Sibyl Jacobson, *Monitoring the Results of Grantmaking, in THE CORPORATE CONTRIBUTIONS HANDBOOK*, *supra* note 74, at 265, 267; see *infra* note 304 (citing advice from marketing and fundraising literature that managers conduct corporate giving in a more business-like manner).

446. MITCHELL, *supra* note 92; USEEM, *supra* note 119; and Haley, *supra* note 313.

tempts to balance the conflicting theories of corporate purpose.<sup>447</sup> Critics on the right assert that the very notion of corporate giving is inconsistent with the overriding goal of the corporation — profit maximization. Observers on the left warn that too much “corporate” negates the “giving.” Moreover, they assert that corporate giving is a means by which corporations exercise social/political power.

Milton Friedman speculated that corporate managers consciously mislabel certain advertising expenses as charitable contributions, presumably to take advantage of the “halo effect.”<sup>448</sup> Friedman responded:

I don't want to blame the corporation for doing that [calling advertising expenses charitable contributions]. The corporation's managers have to behave in a way that will promote the interest of their corporation. It's the rest of us, who make it worth their while to talk that nonsense, to whom I object.<sup>449</sup>

Professor Blumberg, who appears to believe in corporate altruism, wrote that corporate managers “disguise corporate philanthropy in terms of pretended self-interest.”<sup>450</sup> Once again, the dual (and arguably duplicitous) nature of corporate giving complicates the analysis of the practice, revealing the contradiction inherent within the term “corporate giving.”

Andrews recognized the practical problems presented by this “dual agenda” giving.<sup>451</sup> In 1952, he reported:

One corporation keeps two sets of files, a public file on the needs and accomplishments of various agencies and the contributions made, and a private file on the special concern of the corporation with these agencies, such as interlocking board memberships, customers prominent in the charity, and the need to placate or please special groups.<sup>452</sup>

### Marketing and fundraising literature expresses corporate giving

447. See *supra* notes 129-52 and accompanying text (discussing the ways in which corporate giving has attempted to balance the theories of corporate purpose).

448. Johnson, *supra* note 167, at 14-15. In addition, Friedman remarked, “A lot of what they call charity is really tax-deductible expenses . . . [I]t may well be in the self-interest of a corporation to profess to be socially responsible, whether it is or is not in any meaningful sense.” *Id.* at 15.

449. *Id.* Friedman reiterated this remark by stating, “I don't believe they ought to be contributing at all, unless it's in their immediate, direct pecuniary interest, except insofar as they're doing it at the behest of their stockholders.” *Id.*

450. Blumberg, *supra* note 129, at 171.

451. See *supra* notes 333-444 and accompanying text (discussing various justifications for corporate transfers to charity).

452. ANDREWS, *supra* note 79, at 114.

as the latest trend in profit maximization.<sup>453</sup> Empirical studies, however, show no correlation between socially responsible corporate behavior and profits.<sup>454</sup> The shared belief that corporate giving is good for the corporate bottom line encourages managers and fundraisers to promote giving as apparently socially responsible and always profitable. Thus, individuals engaged in the practice of corporate giving balance competing theories of corporate purpose.

## 2. Corporate Giving as Social Currency

Corporate transfers to charity can be viewed as an exercise of corporate power designed to advance far-reaching corporate social, political, and economic goals.<sup>455</sup> Capitalizing on the “halo effect,” corporations use corporate giving to effect the symbolic transmission of corporate values to various stakeholders.<sup>456</sup> Useem described the use of corporate giving to further classwide interests as a kind of social currency.<sup>457</sup> He theorized that an “inner circle” was created by “intercorporate networks through shared ownership and directorship of large companies.”<sup>458</sup> Useem contended that “corporations more integrated into the inner circle display a greater commitment to culture,”<sup>459</sup> because charitable giving promotes the common interests of both the business and cultural elite. Accepting the profit

---

453. See *supra* notes 333-444 and accompanying text (discussing advertising, marketing, public relations, and future investments).

454. See *supra* notes 300-18 and accompanying text (discussing the relationship between corporate giving and business success).

455. USEEM, *supra* note 119, at 3; Haley, *supra* note 313, at 492-94; see generally MITCHELL, *supra* note 92 (arguing that corporations are political institutions that must justify their power).

456. Haley, *supra* note 313, at 494, 497-99.

457. USEEM, *supra* note 119, at 3 (“I will argue that a politicized leading edge of the leadership of a number of major corporations has come to play a major role in defining and promoting the shared needs of large corporations in two of the industrial democracies, the United States and the United Kingdom.”); see also HALL, *supra* note 97, at 97 (noting that contributions serve class interests of large donors and businesses); Haley, *supra* note 313, at 491-92 (discussing corporate contributions as social currency).

458. USEEM, *supra* note 119, at 3. According to Useem, the inner circle emerged with the rise of institutionalized capitalism in the first half of the twentieth century. *Id.* at 3-4. In 1913, the Pujo Committee, named for Democratic member of Congress from Louisiana, Arsene Pujo, conducted an investigation of the extent of concentration in U.S. industry. MITCHELL, *supra* note 92, at 98. Mitchell cited the Pujo Committee and its findings to question Useem’s time-line which places social responsibility as a by-product of “institutional capitalism.” *Id.* at 153. “The historical evidence, however, suggests a different evolution than the one Useem describes, or at least a different chronology.” *Id.* Mitchell pointed out that interlocking directorships were uncovered by the Pujo Committee and that J.P. Morgan testified he held 39 such positions. *Id.* at 98, 153.

459. USEEM, *supra* note 119, at 121-22, 126.

maximization model of the corporation,<sup>460</sup> Useem described the promotion of "classwide profit growth" as a "second, distinct calculus that guides some corporate decisions."<sup>461</sup>

Useem reported that a corporate manager will give to charitable projects endorsed by a peer at another corporation, regardless of the relevance of the charitable cause to his or her corporation.<sup>462</sup> This assertion is supported by a study involving the CEO's of firms located in the Minneapolis-St. Paul area. The survey indicated that contributions to local charitable causes increase when the corporate managers socialize with the directors and leaders of the charitable organizations.<sup>463</sup> This supported Useem's construction of an elite overlapping group of corporate, charitable, and governmental representatives who direct and influence social policy outside of the governmental framework.<sup>464</sup> This elite group directs social policy decisions without the checks and balances imposed on the governmental decision-making process<sup>465</sup> because this elite group determines which cause is worthy of financial support which in turn is subsidized by current federal tax policy.<sup>466</sup>

Haley expanded on Useem's concept of corporate giving and argued that "managers use corporate contributions to influence various stakeholders including stockholders, consumers, employees, investors, [and] public[] and societal institutions."<sup>467</sup> Thus, Haley viewed corporate giving as a symbolic means to influence stakeholder opinion and secure access to policy makers who "can insulate corporations from regulation and taxes, and can inform managers of

460. Useem noted that "profit growth is the overriding objective of corporate action." *Id.* at 148.

461. *Id.*

462. *Id.* at 123. Useem observed, "[E]xecutives who are targets of the [charitable] campaigns report that it is virtually impossible to reject the personal appeal of another corporate manager, despite the irrelevance of the contribution from the standpoint of the company's operations." *Id.* at 123-24.

463. Haley, *supra* note 313, at 492.

464. USEEM, *supra* note 119; Haley, *supra* note 313, at 492 (noting that "[t]he establishments that receive contributions often become privileged places for corporate entertainment.").

465. See Lashbrooke, *supra* note 9, at 242 (concluding that "[c]orporate social responsibility shifts the decision from the government to the corporation—in other words, to the corporate directors and officers who are not accountable to the public nor even to the shareholders"); Davis, *supra* note 119, at 69 (stating that "[w]ouldn't the kinds of comparative advantages enjoyed by the large corporation also be realized, and to a much greater degree, by turning the matter over to the federal government, to serve as the central disperser of, and assessor for, charitable largesse").

466. For a discussion of tax expenditures, see *infra* notes 488-522 and accompanying text.

467. Haley, *supra* note 313, at 485.

environmental changes."<sup>468</sup>

### 3. *Corporate Giving as a Defensive Strategy*

Discussions of corporate transfers to charity reverberate with the conviction that "[t]he major objective of corporation giving is to preserve and maintain the vital private sectors in the corporate environment."<sup>469</sup> Throughout recent history, the corporate environment has been subject to many perceived threats, the most fundamental of which was the fear of encroaching Communism. Indeed, corporations dedicated to profit maximization could not exist in the absence of private property. The Marxist promise to collectivize the ownership of the means of production and institute a dictatorship of the proletariat posed a direct threat not only to corporate legitimacy, but to continued corporate survival.<sup>470</sup>

Mitchell described corporate giving as a defensive strategy — "a response to threats to corporate legitimacy"<sup>471</sup> necessary to forestall "legislation and regulation" that would restrict or limit corporate power.<sup>472</sup> Mitchell believed that corporate social responsibility emerged in response to the critique of corporate power advanced (and popularized)<sup>473</sup> during the Progressive Era.<sup>474</sup>

468. *Id.* at 496. Haley added, "[C]ontributions become cultural, warning systems, indicators of changing environments and threats to corporate stability." *Id.* at 497.

469. EELLS, *supra* note 74, at 137. Eells wrote: "[C]orporate giving is essentially an allocation of certain corporate assets to uses regarded as best in the long run for both the corporation and the society on which it depends . . . . Corporate giving is an investment in a favorable corporate environment . . . ." *Id.* at 189.

470. To Eells, the danger of communist expansionism presented a challenge to corporate leaders. *Id.* at 190-91. Attempting to sound the alarm, he wrote:

Today, corporate managers find themselves at the core of a "twentieth-century capitalist revolution"—a humane movement that stands in contrast to inhumane collectivist drives in some other parts of the world. Many business leaders will take in their stride the responsibilities inherent in this position at the heart of our "capitalist revolution."

*Id.*

471. MITCHELL, *supra* note 92, at 53. Mitchell defines legitimacy as "the belief among groups within the affected population—workers, consumers, stockholders, and managers themselves—that the exercise of power is justified." *Id.* at 56.

472. *Id.* at 62. Mitchell expressed the nexus between legitimacy and power as follows: "Failure to establish legitimacy jeopardizes power; it may prompt legislation and regulation, and even endanger the corporation's survival." *Id.*

473. *See id.* at 88 (discussing political party platforms criticizing each other surrounding the issue of the large corporation). Mitchell stated that the Progressive era did not constitute "a new order of criticism, but rather . . . existing criticisms were transformed into popular beliefs." *Id.* at 107.

474. Citing the Presidential election of 1912 as "the high noon of Progressivism," Mitchell

Early corporate giving texts support Mitchell's theory regarding threats to corporate legitimacy.<sup>475</sup> The classic corporate giving texts by Andrews and Eells wholeheartedly embraced Cold War sentiments dedicated to preserving the free enterprise system.<sup>476</sup> Both Andrews and Eells continually advanced corporate giving as a means to stem the Red Tide, stressing the nexus between the maintenance of capitalist free market hegemony and continued corporate existence. As Eells wrote, "The corporate philanthropist must decide to throw his weight on the side of the legitimate preserves of human freedom in this critical struggle."<sup>477</sup>

The sanctity of private property is a persistent theme throughout Eells' 1956 book entitled *Corporation Giving in a Free Society*.<sup>478</sup> In an especially impassioned passage, Eells described private property:

It goes to the roots of constitutionalism as a theory of government in our western political tradition.

The constitution of a society of free men must preserve the vital private sectors as a counterpoise to tyranny. If they were to be progressively absorbed into the State, the corporate environment of free enterprise for industry would rapidly disappear.<sup>479</sup>

In a somewhat less desperate tone, Eells advocated that a corporation must regulate itself or be regulated.

It would be a matter of good fortune if an excessive growth of the power of the State could be stopped at the threshold of corporate enterprise, or any other "private governing power," simply by the development of a "corporate

discussed various governmental and social initiatives that constituted a threat to corporate legitimacy. *Id.* at 88-91. In particular, Mitchell noted the rise of trade unionism. *Id.* at 43-51. A traditional explanation of "welfare capitalism" describes it as a response to the use of trade unionism. *Id.* at 43 (citing IRVING BERNSTEIN, *THE LEAN YEARS* 187 (1966), and STUART BRANDES, *AMERICAN WELFARE CAPITALISM* 32 (1976)). Mitchell conceded that corporate social policy "was not simply the product of a moment in history—although particular historical circumstances gave substance to the problem of corporate legitimacy and the solution chosen—but of a continuing dynamic." *Id.* at 51; *see also* Horwitz, *supra* note 111 (examining the history of corporate theory and arguing that the natural entity theory emerged a decade after 1886 and was gradually absorbed); Millon, *supra* note 104 (considering how corporate theories have changed over the last 150 years).

475. *See, e.g.*, ANDREWS, *supra* note 79 (The Russell Sage Foundation underwrote the publishing of Andrews' classic text). This showed clear financial motivation on the part of a charitable organization and a desire to package charity for the corporate consumer).

476. ANDREWS, *supra* note 79; EELLS, *supra* note 74, at 188 ("The corporate donor with 'the far vision and the near look' has it within his power to aid in securing the survival of free enterprise and in toughening the sinews of our liberating way of life.").

477. EELLS, *supra* note 74, at 106.

478. *Id.* at 105.

479. *Id.*

conscience," or by constitutionalizing the internal arrangements of these private associations.<sup>480</sup>

Congressional activity during the 1950's further supports the link between threats to corporate legitimacy and transfers to charity. In 1952, the House of Representatives formed the Cox Committee to investigate private foundations for alleged "subversive" and "un-American" activities.<sup>481</sup> When the Cox Committee announced that private foundations did not pose a threat to the American way of life,<sup>482</sup> a disgruntled minority member of the committee, B. Carroll Reece, pressed for a more probing investigation. The Reece Committee convened in 1954 to investigate private foundations which Representative Reece believed were involved in "a diabolical conspiracy" for "the furtherance of socialism in the United States."<sup>483</sup> Writing only two years after the conclusion of the Committee's investigation, Eells remained sensitive to the bad publicity.<sup>484</sup>

The corporation occupies a prominent place in the *power structure* of American society; and before corporations enter upon far-reaching programs of philanthropy this fact must be fully understood. For philanthropy itself is an exercise of power which is susceptible of misunderstanding and even of abuse, as the recent Congressional investigations demonstrate. The problem is not simply one of using charitable contributions as an expression of the "corporate conscience."<sup>485</sup>

Eells reported that "[t]he leading foundations became alarmed" and they went to great lengths to counteract the negative image of the charitable foundations fostered by the hearings before the Cox Committee and the Reece Committee.<sup>486</sup>

Post Cold War geopolitics require corporations to consider a host

480. *Id.* at 99.

481. *Id.* at 46-52.

482. *Id.* at 47. Eells described the results of the Cox Committee as unremarkable. *Id.* at 47-48. He mentioned that its report "sought to quiet the fears of 'many of our citizens' who are skeptical about foundation work in the field of the social sciences, and who 'confuse the term 'social'. . . with socialism.'" *Id.* at 47.

483. *Id.* at 49.

484. This is evident from the fact that Eells devoted a chapter in his book on corporate giving to the topic of the hearings and their effect on the charitable community. *See id.* at 44-71 (discussing the hearings and their implications).

485. *Id.* at 87.

486. *Id.* at 52-58. Eells provided a very colorful account of the antics of Congressman Reece. *See id.* at 49-52 (discussing this account of Reece). Apparently, Chairman Reece had particular difficulty accepting the foundation-sponsored Kinsey report on human sexuality. *Id.* at 65-66. Eells stated that "one committee member seemed to find the very discussion of the Kinsey report a repugnant subject." *Id.* at 66 (referring to Reece).



of threats to corporate legitimacy, and not simply fixate on a single evil. Consequently, corporate giving must go global. Mitchell provided an example of this global perspective with the following excerpt from the stated social policy of the International Bank of America.

No matter how well an international bank performs on a global scale, if it fails to listen actively and respond visibly to the social needs prevalent in individual markets, it can become a broad target for strangling legislation, regulation, nationalization, or even for violent mob or terrorist attacks. All multinational corporations, and banks in particular, must reinforce the public perception that business is serving society's needs.<sup>487</sup>

### III. TAX EXPENDITURE ANALYSIS REDUX

The recognition that corporate giving is the functional equivalent of advertising and public relations expenditures fundamentally alters any analysis of the tax expenditure (i.e., foregone federal tax revenue) for corporate transfers to charity. This is because the corporate income tax deduction for advertising and public relations services<sup>488</sup> under section 162 is considered a normative adjustment and not a tax expenditure.

The tax expenditure theory starts from the basic premise that within a given tax system,<sup>489</sup> in this case the federal income tax system, certain normative adjustments (i.e., deductions, exclusions, credits) are necessary to measure the tax base. All other adjustments represent tax expenditures — a policy decision to subsidize certain activities by foregoing federal revenue — revenue that would have been collected under the normative provisions.<sup>490</sup> In the case of the charitable contribution deduction, a \$100x corporate charitable deduction removes \$100x from the corporation's taxable income,<sup>491</sup>

---

487. MITCHELL, *supra* note 92, at 59 (citation omitted).

488. See *supra* notes 238-41 and accompanying text (discussing the nondeductibility of goodwill).

489. Tax expenditure analysis is equally applicable to federal transfer taxes and other excise taxes.

490. An enduring criticism of the tax expenditure theory is that it is not possible to differentiate between normative deductions and policy-driven deductions. SURREY & MCDANIEL, *supra* note 181, at 196. Beyond this objection, some commentators propose alternative normative assumptions. Calling the current normative assumptions in tax policy 'realist,' Professor Griffith analyzed the taxation of personal injury recoveries under various models of alternative tax policy norms. Thomas D. Griffith, *Should "Tax Norms" Be Abandoned? Rethinking Tax Policy Analysis and the Taxation of Personal Injury Recoveries*, 1993 WIS. L. REV. 1115.

491. This assumes that the corporate donor is entitled to deduct the entire \$100x in the year of the transfer.

resulting in \$35x of foregone federal revenue.<sup>492</sup> The tax expenditure theory identifies this lost revenue as an indirect federal subsidy to the charitable recipient administered through the Internal Revenue Code.<sup>493</sup> Since 1974 tax expenditures have been reflected in the federal budget.<sup>494</sup>

A tax expenditure analysis of a particular deduction presupposes an ability to describe the behavior sought to be encouraged by the deduction. A misdescription of the behavior in fact subsidized by the corporate charitable contribution distorts the budgetary review process<sup>495</sup> and makes any resulting consensus concerning the equity or efficiency of the corporate charitable contribution deduction meaningless. The approval of a subsidy for corporate transfers to charity without the expectation of any commensurate benefit in return is not transferrable to a subsidy for the purchase of corporate goodwill. However, once corporate giving is recast, traditional tax expenditure analysis is no longer applicable<sup>496</sup> because the corporate income tax deduction for advertising and public relations services under section 162 is considered a normative adjustment.

The mischaracterization of corporate giving reinforces the "halo effect" by insuring that the public debate surrounding the deduction never questions the "charitable" nature of the transfer. Instead, arguments pro and con drift to broader policy issues, such as the need to increase federal tax revenue and general principles of equity and efficiency. The public and the legislature, however, cannot evaluate

---

492. See *supra* notes 177-81 and accompanying text (discussing the consequences of a charitable contribution made by a corporation in the top marginal tax bracket).

493. Viewed as an indirect subsidy, tax expenditures are considered the equivalent of direct spending programs. SURREY & MCDANIEL, *supra* note 181, at 86.

494. The Congressional Budget Act of 1974, Pub. L. No. 93-344, 308, 88 Stat. 297, 313 (1974) (codified as amended at 2 U.S.C. 639(c)(3)(1988)). Professor Surrey argued persuasively that tax expenditures should be reflected in the federal budget and subject to the same level of review as direct federal subsidies. SURREY, *supra* note 181, at 3-4. The 1974 Congressional Budget Act required the federal budget to include these "hidden" federal expenditures.

495. When first proposed, the goal of the tax expenditure theory was to expose indirect federal expenditures concealed as favorable tax treatment for certain taxpayers or certain expenditures. The favorable tax treatment was designed to encourage specific behavior and thereby implement economic or social policy. Professor Surrey argued persuasively that such indirect expenditures should be subject to debate and scrutiny "on the books" as federal expenditures. See *supra* notes 181 and accompanying text (discussing Professor Surrey's views).

496. Except perhaps in the few instances where transfers deductible under section 170 enjoy more favorable treatment than those deductible as ordinary and necessary business expenses (e.g., capital expenditures, inventory property, gifts of long-term capital gain property) under section 162. See *supra* notes 225-51 and accompanying text (discussing situations where traditional tax expenditure analysis may be applicable).

these broader policy issues until the practice of corporate giving is understood as a corporate expenditure for advertising or public relations services.

The classic tax expenditure analysis measures the equity and efficiency of the tax provision against that of an equivalent direct spending program.<sup>497</sup> Particularly in the case of the charitable contribution deduction, the equity inquiry illustrates the "upside-down" nature of a tax expenditure.<sup>498</sup> Higher income taxpayers receive a greater benefit because the value of the subsidy is a function of the taxpayer's top marginal rate of tax. In the case of a taxpayer in the 15% top marginal tax rate, a \$100x transfer to a qualified charity costs the taxpayer \$85x (\$100x less \$15x [15% of \$100x]).<sup>499</sup> The same transfer, however, costs a higher income taxpayer in the 39.6% top marginal tax rate only \$60.4x (\$100x less \$39.6x [39.6% of \$100x]). This means that higher income taxpayers can direct (and benefit from) a disproportionate share of the tax expenditure budget. Non-taxpayers do not participate at all.<sup>500</sup> Professor Surrey noted that this upside-down impact of tax expenditures is "the primary cause of the perceived tax inequity" on the part of the public.<sup>501</sup>

From an efficiency standpoint, the corporate charitable deduction does not fare well when compared to a direct spending program established to fund the activities of charitable organizations.<sup>502</sup> First, the individual giving patterns of corporations determine the extent to which organizations (and causes) receive funding.<sup>503</sup> In addition, there is a hidden cost in such transfers because the charitable recipi-

---

497. Professor Surrey generally favored direct expenditures over tax expenditures citing numerous inefficiencies and inequities. SURREY, *supra* note 181, at 126-54. *Contra* Zelinsky, *supra* note 181, at 1167 (defending tax expenditures by portraying "tax institutions as more pluralist and less capturable").

498. SURREY & MCDANIEL, *supra* note 181, at 72 (noting that "[t]he overwhelming majority of tax expenditure programs disproportionately benefit the upper-income groups.>").

499. *See supra* note 177 and accompanying text (discussing this formula). In 1993, there were five different individual rates, ranging from 15% to 39.6%. I.R.C. § 1(a) (West 1993).

500. SURREY & MCDANIEL, *supra* note 181, at 72. The phrase "non-taxpayers" includes all individuals below taxable levels, loss proprietorships, and loss corporations. In the case of the individual charitable deduction, it also includes non-itemizers because the section 170 deduction reduces adjusted gross income. *Id.* at 81.

501. *Id.* at 72. Tax expenditures "fail to achieve what most Americans would perceive to be a fair distribution of funds, measured by criteria applied to direct spending programs." *Id.*

502. *Id.* at 82-87.

503. Certain commentators contend that corporations will not make transfers to controversial causes. *See supra* note 329-30 and accompanying text.

ent receives the funds in exchange for the provision of services. The quid pro quo nature of the transaction requires the charitable recipient to divert its resources from the fulfillment of its charitable purpose, thereby decreasing the value of the transfer.<sup>504</sup> Clearly, this approach is not as efficient as a direct federal subsidy unless the contemplated federal policy is to encourage charitable organizations to become more entrepreneurial and learn how to earn their own funds.<sup>505</sup>

A sustained criticism of the tax expenditure theory relates to its central premise, namely that certain adjustments to income are normative (i.e., required by the nature of the particular tax base). Commentators differ as to which adjustments are indeed normative<sup>506</sup> and, on a more fundamental basis, differ as to whether any meaningful distinction can be made between items classified as normative adjustments as opposed to those classified as tax expenditures.<sup>507</sup>

A case in point is the exemption from federal income tax for charitable organizations.<sup>508</sup> The tax exemption for charities is not included in the tax expenditure budget presumably because the charitable exemption from federal income tax is considered a normative provision.<sup>509</sup> A corporate transfer to charity is first deductible to the corporation and then excludable from the taxable income of the charity. The second subsidy is not currently reflected in the tax expenditure budget. Ironically, the first subsidy is included, but not accurately described. When corporate giving is viewed as a

---

504. Obviously, charities have administrative costs associated with any fund-raising effort. In addition, the corporation benefits from purchasing the services free of tax.

505. Non-profit organizations believe that they are under considerable pressure to be more entrepreneurial. See, e.g., Richard Steckel, *Developing an Entrepreneurial Vision*, NONPROFIT WORLD, May-June 1993, at 20 (reporting how one charity developed a way to become self-sufficient).

506. See *supra* note 490 (citing criticism of the distinction between normative adjustments and tax expenditures).

507. See *infra* note 509 (discussing the unexplained failure to classify tax exemption of charitable organizations as a tax expenditure).

508. Charitable organizations entitled to receive tax-deductible contributions under section 170(c) are exempt from federal income tax under section 501(c)(3) on income substantially related to their exempt purpose. Income generated from a trade or business regularly carried on and not substantially related to the organization's exempt purpose is subject to unrelated business income tax imposed under section 511, subject to certain exclusions and modifications.

509. SURREY & MCDANIEL, *supra* note 181, at 219 ("U.S. tax expenditure lists have not included any item related to non-profit, tax-exempt organizations, nor have they given any reason for this omission. As the following analysis indicates, the U.S. tax treatment of nonprofit organizations should be classified as a tax expenditure.").

purchase, the donee's exemption from federal income tax on the receipt of the transfer could constitute a tax expenditure. To illustrate, assume that a corporation transfers \$100x to a qualified charitable donee in connection with a corporate sponsorship program.<sup>510</sup> The corporation's after tax cost of the \$100x transfer is only \$65x with the remaining \$35x of the transfer representing a tax expenditure. The donee receives \$100x and is exempt from federal income tax on that amount. The exemption produces a second tax savings of \$35x which is not reflected as a tax expenditure under traditional tax expenditure theory.<sup>511</sup> Thus, the \$100x transfer is subject to a double tax subsidy: (1) the corporation's deduction (\$35x); and (2) the donee's exemption (\$35x).

The second tax subsidy is easier to see when the tax treatment of the \$100x sponsorship fee is contrasted with the treatment of a \$100x corporate advertising expense.<sup>512</sup> The corporation is entitled to deduct the advertising expense<sup>513</sup> and the after-tax cost of the \$100x transfer is \$65x.<sup>514</sup> Unlike the donee charitable organization, however, the advertising agency must include the \$100x in its gross income and pay federal income tax on that amount, subject to allowable deductions, at its top marginal rate of tax.

The recharacterization of the corporate charitable deduction as a normative adjustment shifts attention to the unacknowledged tax expenditure enjoyed by the charitable donee. Even if one accepts the classification of the charitable exemption as a normative feature,<sup>515</sup> the exemption from federal income tax only applies to amounts substantially related to the performance of the organization's exempt function.<sup>516</sup> An otherwise "exempt" organization is subject to unre-

---

510. For a discussion of corporate sponsorship of charitable causes and events, see *supra* notes 333-43 and accompanying text.

511. SURREY & MCDANIEL, *supra* note 181, at 219.

512. See *supra* notes 333-91 and accompanying text (discussing the similarity between corporate charitable contributions and advertising costs).

513. Generally, advertising expenses are immediately deductible from gross income under section 162. For a comparison of immediately deductible advertising expenses to capital expenditures, see *supra* notes 238-41 and accompanying text.

514. Ordinary and necessary business expenses deductible under section 162 are considered a normative adjustment and not a tax expenditure. I.R.C. § 162 (West 1994).

515. *Contra* SURREY & MCDANIEL, *supra* note 181, at 219-20 (arguing forcefully that tax exemption for non-profits should be included in tax expenditures).

516. Relatedness is defined within the context of being "substantially" related where the facts and circumstances of each activity considered for tax-exemption must meet a two prong test: (1) there must be a link between the business activity of the company and the tax exemption the company is seeking; and, (2) the tax exempt activity must contribute "importantly" to the funda-

lated business income tax<sup>517</sup> on income from a trade or business, regularly carried on, and not substantially related to its exempt purpose.<sup>518</sup> The initial question is whether the provision of advertising services or public relations services constitutes an unrelated trade or business.<sup>519</sup> If so, then a specific exemption for amounts received in exchange for the performance of such services warrants review as a tax expenditure because it is not simply a normative adjustment to unrelated business income.<sup>520</sup>

The existence of a federal subsidy for the provision of corporate advertising and public relations services by a charitable organization raises serious questions of equity and efficiency. For example, such a subsidy permits the charitable organization a considerable advantage over a commercial advertising firm because the charity operates free of tax.<sup>521</sup> This presents the very type of unfair competition that the unrelated business income tax was designed to prevent.<sup>522</sup>

### CONCLUSION

As the foregoing discussion amply shows, corporate charitable giving is big business. Each year, corporations transfer billions of

mental business of the company, including the gross income earned by the activity (the IRS closely scrutinizes how much income is earned, i.e. not too much and not too little). HOPKINS, *supra* note 61, at 719-24. Where a tax-exempt organization was established to provide therapeutic services for emotionally disturbed adolescents and the organization had the adolescents staff a retail grocery store in order to stabilize their emotional rehabilitation through public exposure, the IRS found this activity met its criteria for tax-exemption. *Id.* at 721 (citing Rev. Rul. 76-94, 1976-1 C.B. 171).

517. I.R.C. § 511(a)(1) imposes tax on the unrelated business taxable income at the corporate rate imposed under section 11. I.R.C. § 511 (a)(1) (West Supp. 1994).

518. I.R.C. § 513(a) defines unrelated trade or business as:

"[A]ny trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption. . . .

*Id.* § 513(a) (West 1994).

519. *See supra* notes 333-409 and accompanying text (discussing corporate giving as a form of advertising and public relations).

520. An organization is entitled to reduce its unrelated business income by any otherwise allowable deduction which is directly connected to the trade or business. I.R.C. § 512(a)(1) (West Supp. 1994). In addition, various items are specifically excluded from unrelated business income, including certain investment income, rents, and royalties. *Id.* § 512(b)(1)-(3).

521. *See supra* notes 386-91 and accompanying text (discussing how the exemption of corporate sponsorship payments from UBIT unfairly disadvantages commercial advertising agencies).

522. *See supra* text accompanying notes 388-91 (arguing for the inclusion of sponsorship payments in the unrelated business income of charities).

dollars to charitable organizations.<sup>523</sup> Corporate managers and fundraisers find nothing mysterious or paradoxical about the popularity of corporate transfers to charity. Associating the corporate name with a charity or charitable cause is good for the corporate image and at some point what is good for the corporate image is good for the corporate bottom line.<sup>524</sup> As the title of one marketing text promises, corporate giving means "doing best by doing good."<sup>525</sup>

Traditional legal scholarship, however, has not asked corporate managers what motivates them to authorize transfers to charitable organizations. Instead, legal scholarship begins with a false assumption. It accepts that corporate giving involves the transfer of corporate assets to charity without the expectation of a commensurate benefit. The presumed absence of a quid pro quo relationship then propels commentators to analyze the practice of corporate giving in light of various theories of corporate purpose and tax policy considerations.<sup>526</sup> Both approaches miss the point of corporate giving — to enhance the corporate bottom line. Socially responsible behavior has become profitable.<sup>527</sup> The corporate theory analysis asks whether disinterested corporate giving is consistent with the purpose of the corporation. The answer to that question depends on which theory of corporate purpose one adopts.<sup>528</sup> The profit maximization model of the corporation has no room for corporate generosity (i.e., giving away corporate assets without receiving a commensurate benefit in return). Such corporate altruism is antithetical to a corporate purpose dedicated to maximize shareholder profit and gain. On the other hand, the social responsibility model of corporate purpose approves of disinterested corporate giving as an integral part of corporate activities.

The tax policy approach accepts the distinction in the Internal Revenue Code between corporate transfers to charitable organiza-

---

523. In 1992, corporations transferred \$6 billion to charitable organizations. See *supra* note 1 and accompanying text. For a discussion of charitable giving statistics, see *supra* notes 59-72 and accompanying text.

524. See *supra* notes 300-18 and accompanying text (discussing the perceived business benefits of corporate giving).

525. SIMON & STECKEL, *supra* note 7.

526. In 1992, corporations transferred \$6 billion to charitable organizations. See *supra* note 1 and accompanying text.

527. The proliferation of cause-related marketing and corporate sponsorship are but two examples of this growing trend. See *supra* notes 355-91 and accompanying text.

528. For a discussion of the theory of corporate purpose and the history of corporate giving, see *supra* notes 73-152 and accompanying text.

tions without the expectation of a commensurate benefit in return and all other corporate transfers to charity.<sup>529</sup> It explains that the only reason corporations give to charity is to realize certain tax benefits.<sup>530</sup> The tax benefit provides the tangible benefit missing due to the lack of quid pro quo. It becomes the motivating force behind corporate giving. As explained, tax considerations only affect the cost of the transfer and a corporate transfer to charity will never result in a net benefit to the corporate donor.<sup>531</sup>

It is not clear why legal scholarship has failed to take into account the common understanding of a practice it purports to analyze. A possible explanation lies in the dual view of corporate transfers to charity pronounced by the Internal Revenue Code. The corporate charitable contribution deduction under section 170 very clearly envisions a disinterested corporate transfer to charity<sup>532</sup> and section 162(b)<sup>533</sup> goes to great lengths to describe how to distinguish such a true corporate contribution from all other corporate transfers. This bifurcated construction of corporate giving undoubtedly influences the ability of legal commentators to conceptualize corporate giving.

The codification of the distinction between disinterested corporate giving and all other types of giving was the result of certain historical and intellectual forces surrounding the original enactment of the corporate charitable contribution deduction.<sup>534</sup> This does not explain why the notions of corporate altruism and social responsibility factored so heavily in the 1981 debate concerning the liberalization of the corporate charitable contribution deduction.<sup>535</sup> Almost fifty years after the enactment, the federal government continues to appeal to the corporate "conscience" in an effort to raise nontax revenue.<sup>536</sup> One explanation is that the federal government has become

---

529. See *supra* notes 225-237 and accompanying text (discussing the overlap between section 170 and 162).

530. See *supra* note 273.

531. See *supra* notes 177-81 and accompanying text (discussing the favorable tax treatment afforded certain contributions of inventory).

532. For a discussion of the requirements for the corporate charitable contribution deduction, see *supra* notes 182-224 and accompanying text.

533. For a discussion of the determination of which transfers constitute business expenses, see *supra* notes 225-51 and accompanying text.

534. For a discussion of the historical context of the 1935 enactment of the deduction, see *supra* notes 73-128 and accompanying text.

535. See *supra* notes 159-62 and accompanying text (discussing the 1981 debate).

536. See *supra* notes 415-19 and accompanying text (discussing President Bush's New American Schools Development Corporation).



accustomed to using the rhetorical force of social responsibility in its attempt to attract corporate funding for various social programs. Whenever the federal government employs the language of social responsibility, however, it helps perpetuate the myth of corporate altruism.

The myth of corporate generosity produces the "halo effect" which in turn enhances the benefit a corporation receives from transfers to charity.<sup>537</sup> Marketing texts explain that the "halo effect" is the reason that corporate transfers to charity are so cost effective, resulting in some cases in "more bang for your buck."<sup>538</sup> In short, the "halo effect" permits corporate managers to choose between giving \$100 to a for-profit advertising agency or \$50 (or less) to the friendly neighborhood charity.

The disjunction between the practice of corporate giving and the way such behavior is understood in legal scholarship has an effect beyond simply the production of a body of scholarly work unrelated to the practice it purports to explain. It also influences the federal budget tax expenditure analysis.<sup>539</sup> The current tax expenditure for the corporate charitable contribution deduction is based on a fundamental misunderstanding of the nature of corporate giving. One way to unravel this misunderstanding is to repeal the section 170 corporate contribution deduction.

Once the section 170 corporate charitable contribution deduction is repealed, a corporate transfer to charity is treated like any other corporate transfer and any deduction available for a corporate transfers to charity is no longer a tax expenditure.<sup>540</sup> Thus, the misunderstanding appears to have produced no harm.

This conclusion is too simplistic. The effort to understand the motivation of the corporate donor, overlooks the role of the charity — the recipient.<sup>541</sup> Generally, a qualified charitable organization is exempt from tax on income related to its exempt purpose. If a corporate transfer to charity is the equivalent of the purchase of advertising or goodwill, then the receipt of such transfers should not be

---

537. See *supra* notes 319-32 and accompanying text (discussing the "halo effect").

538. See *supra* notes 387-91 and accompanying text (discussing the John Hancock sponsorship of the Cotton Bowl).

539. See *supra* notes 488-522 and accompanying text (discussing tax expenditure theory).

540. See *supra* note 496 and accompanying text (discussing the relative benefits of the charitable contributions deduction and the business expense deduction).

541. See *supra* notes 512-22 and accompanying text (discussing corporate sponsorship and advertising expenses).

exempt from tax because the provision of advertising services and the sale of goodwill is not substantially related to any exempt purpose under Section 501(c)(3). Therefore, the exemption of such receipts is a non-normative adjustment that must be identified as a tax expenditure. This requires the focus to shift to the recipient of the transfer — the charitable donee.

This hidden subsidy for transfers to charity must be addressed in the same terms used by corporate managers and fundraisers. The question then becomes whether the federal government should subsidize the sale of charitable goodwill by charitable organizations to corporate purchasers. The policy underlying the unrelated business income tax (i.e., elimination of unfair competition) suggests very strongly that the answer should be “no.” The receipt of \$6 billion a year in exchange for providing certain promotion activities free of tax places the charitable recipient at an immediate advantage over for-profit entities.<sup>542</sup> In fact the Internal Revenue Service reached exactly that conclusion in the case of corporate sponsorship payments, but pressure from the exempt community resulted in a reversal of its decision.<sup>543</sup>

A meaningful debate concerning the exemption of the receipt of corporate transfers to charity can proceed only if corporate giving is recast as the corporate purchase of advertising services or goodwill. The existence of UBIT does not foreclose discussion because federal policy objectives to encourage direct corporate funding to a statutorily-defined group of organizations could override the policy objective of the UBIT unfair competition safeguards. Whatever the result, the debate must take place with as much information of the practice to be subsidized as possible. Society cannot choose to subsidize that which it cannot describe.

---

542. See *supra* note 388.

543. See *supra* notes 367-91 and accompanying text.

