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Corporate Donations to Religious and Educational Bodies

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certainly sacrificed and total uniformity is out of the question for some time to come.[90]

Whatever the solution might be, it is clear that the present state of the law is highly unsatisfactory.

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Corporate Donations to Religious and Educational Bodies

In 1905 the president of a corporation that manufactured pumps and hydraulic machinery attempted to use corporate funds to equip a laboratory of hydraulic engineering at a local university. The court struck down the donation maintaining it was beyond the power of the president to authorize such an expenditure, and expressed doubts whether the gift could be justified even if it had been approved by the directors of the company.[1]

The concept of the corporation at the turn of the century was that it existed for the sole purpose of making a profit for its stockholders. Thus, it is not surprising that charity, as such, was considered contrary to the fundamental nature of the corporation. But a corporate donation might be permitted, even then, if it could be shown that the company would obtain some tangible benefit from it. In the words of *Hutton v. West Cork Ry. Co.*: "[C]harity has no business to sit at boards of directors qua charity. There is, however, a kind of charitable dealing which is for the interest of those who practice 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."[2]

In 1953 the A. P. Smith Manufacturing Company authorized a donation of $1,500, to the general fund of Princeton University. In upholding the gift the Supreme Court of New Jersey stated: "[T]he appellants, as individual stockholders . . . ought not be permitted to close their eyes to present day realities and thwart the long-visioned corporate action in recognizing and voluntarily discharging its high obligation as a constituent of our modern social structure."[3]

As *Smith* indicates, the notion that a corporation exists solely for the purpose of making profits is no longer an unchallenged idea. On the contrary the corporation is considered to have a duty to society, a duty which it can honorably fulfill by making contributions to charitable, scientific, educational or religious groups.[4]

However, this modern approach to corporate philanthropy cannot be properly understood and evaluated, save in light of the traditional concept of the "corporate benefit." Thus, it is the function of this note to sketch the development and subsequent erosion of the "corporate benefit" doctrine particularly as it applies to gifts for educational and religious groups.

Common Law Development

Hutton v. West Cork Ry. Co.,[5] in 1883, was the first case to provide a clear statement of the status of corporate giving and has become a classic in the field

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90 See, Sweeny, *supra* note 14.

1 Worthington v. Worthington, 100 App. Div. 332, 91 N.Y. Supp. 443 (1905).

2 Hutton v. West Cork Ry., 23 Ch. D. 654, 673 (1883).

3 A. P. Smith Mfg. Co. v. Barlow, 13 N.J. 145, 98 A.2d 581, 590, appeal dismissed, 346 U.S. 861 (1953).

4 Professor Dodd in 1932 was the first to actively advocate the concept of a "corporate duty" which is now much in favor. Dodd, *For Whom Are Corporate Managers Trustees?* 45 Harv. L. Rev. 1145 (1932). For a strong statement of this "corporate duty" concept see the lower court opinion in A. P. Smith Mfg. Co. v. Barlow, 26 N.J. Super. 106, 97 A.2d 186 (1953). See also Prunty, *Love and The Business Corporation,* 46 Va. L. Rev. 467 (1960) for the most recent comment on this area of the law.

5 Hutton v. West Cork Ry. Co., 23 Ch. D. 654 (1883).

even though the fact situation was very unlike the usual corporate gift. *Hutton* involved a payment by the company to certain of its retiring directors. The court ruled that the appropriation was, in effect, a gift and then went on to develop what has become the traditional approach to corporate philanthropy. The basic premise declared in *Hutton* was that a corporation is created for the sole purpose of making profits for its stockholders. Therefore, any action of the board of directors not in keeping with this is ultra vires. On this reasoning, a corporate donation or contribution is permissible if it can be demonstrated that the corporation will receive some direct, tangible benefit. Beyond that, corporate philanthropy is forbidden.

It was not long before "directness" of the benefit became the key question in corporate gift cases. An English court held, in 1888, that a corporation could not properly hire a clergyman or employ a school teacher for its employees unless such a practice was necessary as a means of obtaining workmen. Here "corporate benefit" was strictly construed.[6]

The case of *Steinway v. Steinway & Sons*,[7] in 1896, was more enlightened in allowing the piano company to contribute to the establishment of a church, school, free library and free bath for its employees when it established a company town on Long Island — then far from civilization. But two years later in *People ex. rel Maloney v. Pullman's Palace Car Co.*,[8] the Illinois Supreme Court ruled that Pullman could not provide a church for employees in its company town unless there would be no church facilities otherwise and that it could hire a teacher only if the state law did not provide for one. Professor Cousens has suggested that an essential factor in those cases was the policy question involved in the establishment of a company town. The New York court in *Steinway* had no policy objection to a company town, but the Illinois court did.[9]

About the turn of the century a new fact situation began to appear in corporate donation cases. Whereas the older cases had generally dealt with contributions to benefit the employees of the corporation, the newer cases tended to involve expenditures outside the realm of employee benefits. For example, in *Virgil v. Virgil Practice Clavier Co.*,[10] a corporation organized for the manufacture and sale of a novel musical instrument was permitted to conduct a school in which instruction was given in the use of the instrument. It appears that it was allowed primarily because of the complete novelty of the clavier and the fact that sale of it would be difficult unless people were instructed in its use. Thus, it was considered a legitimate business expense.

The corporate benefit rule was strictly applied in 1915 when a Georgia court held a donation by a railroad toward the construction of a school to be ultra vires. The railroad claimed it would stimulate travel on the road; the court found the benefit too remote.[11]

In 1919 Northwestern University made a contribution of land and money to a nearby hospital. The contribution was allowed on the ground that the University was providing facilities for its medical students to observe the actual treatment of patients. The court reasoned that it was not really a charitable gift as the educational purpose of the University was directly served by it.[12]

Two years later an important and far-reaching decision was rendered in England in *Evans v. Brunner, Mond & Co.*[13] Brunner wished to donate £100,000 to leading English schools and universities to be used "for the furtherance of scien-

6 In re Branksea Island Co., 1 Meg. 12 (1888).
7 17 Misc. 43, 40 N.Y. Supp. 718 (1896).
8 175 Ill. 125, 51 N.E. 664 (1898).
9 Cousens, *How Far Corporations May Contribute to Charity*, 35 VA. L. REV. 401 (1949).
10 33 Misc. 200, 68 N.Y. Supp. 335 (1900).
11 Brinson Ry. v. Exchange Bank of Springfield, 16 Ga. App. 425, 85 S.E. 634 (1915).
12 Northwestern University v. Wesley Memorial Hospital, 290 Ill. 205, 125 N.E. 13 (1919).
13 1 Ch. 359 (1921).

tific education and research." Although the company believed that it could train people in specialties on its own, the objective was to encourage individuals to pursue the sciences and thereby create a pool of talent from which the company could draw. The contribution was allowed on that ground and thereby the court went almost as far in 1921 as *Smith* was to go thirty years later.[14]

About this time a new trend of cases developed which illustrate something of the changing attitude toward corporate philanthropy. The cases prior to 1920 were largely stockholder derivative suits brought by shareholders who argued that their rightful earnings were being dissipated by the directors.

From 1920 on, the stockholder derivative suit became a rarity with a large proportion of the cases being decided in, or on appeal from, the tax court. This might indicate a general acquiescence on the part of stockholders and the acceptance of corporate giving as a permissible mode of corporate activity.[15]

Aspects of Federal Income Taxes

The law of corporate donations is not unlike many other areas of the law in that its development has been significantly influenced by the federal income tax. The substitution of tax court cases for derivative actions did not appreciably change the pattern of litigation, though admittedly, the relative interests of the litigants were not the same. The stockholder is concerned with a reduction of his profits and the basic issue is whether corporate philanthropy is within the authority of the directors. The Internal Revenue Service, on the other hand, is concerned only with what may legitimately be deducted from taxable income. In each case, it seems that the fundamental issue is whether the gift is fairly within the corporate objectives.

The tax question is basically whether the gift is an "ordinary and necessary expense" of the business.[16] In making that determination, the court must consider what benefit is derived by the corporation — essentially the same question that must be faced where the plaintiff is a stockholder.

Thus, much of the litigation over corporate donations has been concerned with tax questions. Although it must be made clear that the two kinds of cases are *essentially* different, the fundamental questions are overlapping, and a complete analysis of the law of corporate donations cannot be undertaken without some analysis of the tax problems.

It should be noted that most of the tax litigation took place before the Internal Revenue Code was amended to allow a corporate deduction specifically for charitable contributions.[17]

The connecting link between the previous cases and the tax cases is found in

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14 However the rationale of the cases were different. *Evans v. Brunner, Mond* emphasized the "pool of trained personnel" while *Smith* concentrated on the necessity of keeping strong and free our private institutions of higher learning.

15 The two recent cases, A. P. Smith Mfg. Co. v. Barlow, 13 N.J. 145, 98 A.2d 581 (1953), and Union Pacific Ry. Co. v. Trustees, Inc., 8 Utah 2d 101, 329 P.2d 398 (1958) are the only reported cases in the last thirty years raised on a non-tax basis.

16 The Revenue Act of 1918, 40 Stat. 1057, followed the 17th Amendment and from the beginning allowed corporations a deduction for ordinary and necessary expenses of business. This provision (now INT. REV. CODE OF 1954, § 162(a)) was first embodied in Revenue Act of 1918, ch. 18, § 234(a), 40 Stat. 1077. See: *The Corporation and the Commonweal: Contributions by Corporations to Private Educational Institutions,* 22 GEO. WASH. L. REV. 710 (1954) for an excellent presentation of the tax cases.

17 INT. REV. CODE OF 1936, ch. 690, § 23(q), 49 Stat. 1661 (now INT. REV. CODE OF 1954, § 162(b)).

18 37 F.2d 798 (D.C. Cir. 1929), *cert. denied* 281 U.S. 742 (1930). The company made a gift to a hospital in the town where two-thirds of the population's working force were employees of the Glass Works. In upholding the donation as a business expense, the court noted that "[T]he power of a corporation employing labor, such as a railroad company, to incur expenses in the employment of medical and surgical aid and the like for employees injured in the performance of their service is recognized to exist by implication." 37 F.2d 798 at 800.

Corning Glass Works v. Lucas,[18] and *American Rolling Mill Co. v. Commissioner*,[19] where the courts inferred that the questions of whether a donation was an ordinary and necessary expense and whether it was ultra vires were the same. Although, it is submitted, the questions are not at all the same, it is true that a consistent holding that a particular type of donation is an ordinary and necessary expense is persuasive authority that it is not ultra vires.

Armstrong Cork Co. v. H. A. Meldrum,[20] decided before the creation of the tax court, was important because the district court authorized receivers of the corporation to make a previously authorized contribution to a local college and university; the donation was for the initiation of business courses. While it did not go so far as *Evans v. Brunner, Mond,* the court did say that because the company needed trained personnel and the recipient schools were local institutions, the donation was a necessary business expense.

In 1926 a contribution made to Tulane University by a bookstore was disallowed, even though the store's business came primarily from Tulane students. The benefit was deemed too remote and it was held to be a contribution rather than a business expense.[21]

The 1920's saw a new series of "employee benefit" cases beginning with *Appeal of Poinsett Mills*[22] in 1924. This case allowed as a business expense the cost of repairing and enlarging the church in the company's mill town. The determining factors, presumably, were that the employees would not have had a church otherwise and that the company believed the work necessary to maintain employee good will.

In a somewhat similar case a deduction was allowed in the name of promoting necessary employee satisfaction when a company donated $10,000 to the local school district to bring the quality of its education up to that of the surrounding districts. Eighty to ninety per cent of the children in the school were children of the employees.[23]

The factor of necessity is a common thread throughout all these "employee benefit" cases. For instance, in *Boucher-Cartwright Coal Co. v. Commissioner*,[24] only thirty per cent of the company's employees were Roman Catholic and these constituted about one-third of the local parish. A donation of $500 to build a rectory was disallowed on the ground that the services could be held without the rectory, and that the building of it was a mere convenience to the priest rather than a necessity for holding religious services.

However, in *Superior Pocahontas Coal Co. v. Commissioner*,[25] where ninety per cent of the community were employees of the corporation and composed three-fourths of the church congregation, a deduction was allowed for a donation to the rebuilding of the only church in town having a regular minister.

In a similar case donations of $280 to each of three local churches were disallowed in the absence of evidence showing that the workers would not have had religious facilities except for the donation. One-fifth to one-third of the respective congregations were made up of the company's employees.[26] However, a deduction

19 41 F.2d 314 (6th Cir. 1930). The court held that a donation to the civic improvement fund in a company town was deductible, noting that "[I]t has been held that expenditures for hospitals, dispensaries, medical services, schools, libraries, churches, and recreational centers are all necessary and proper expenditures in aid of corporate purposes. The Board of Tax Appeals itself has recognized them as an effective means of establishing cordial relations with employees and retaining personnel." *Id.* at 315.

20 285 Fed. 58 (W.D.N.Y. 1922).

21 J. A. Majors Co. v. Commissioner, 5 B.T.A. 260 (1926).

22 1 B.T.A. 6 (1924).

23 Appeal of Holt-Granite Mills Co., 1 B.T.A. 1246 (1925).

24 7 B.T.A. 1 (1927).

25 7 B.T.A. 380 (1927).

26 E. M. Holt Plaid Mills, Inc. v. Commissioner, 9 B.T.A. 1360 (1928).

was allowed the Kekaha Sugar Co. when it provided religious services on the corporate plantation.[27]

There appear to be two basic issues in the "employee benefit" cases. First, if the donation is not made by the corporation, will the employees be deprived of some necessary facility, such as a school or church? Second, will such a deprivation impair the employee relations of the company? Underlying both questions is the broader social issue of the desirability of the facility to the workers. Although it is seldom flatly stated, it appears that this latter social question is more often than not the real justification in the eyes of the court.[28] Perhaps this is an instance of Justice Holmes' famous observation that: "Every important principle which is developed by litigation is in fact and at bottom the result of more or less definitely understood views of public policy. . . ."[29]

Whereas the tax cases of the 1920's turned on whether the contribution was necessary to provide the company employees with some essential facility, the cases in the 1930's revolved mainly around the directness and tangibleness of the benefit received by the company as a result of its making a contribution to schools or colleges.

Where the amount donated was small, frequently a donation would be allowed under the heading of "advertising." For example, *Killian Co. v. Commissioner*,[30] allowed small contributions to local church and civic groups but disallowed a $1,500 donation to a local college because the latter donation was for the college's "lasting benefit" and clearly not for company advertising.

Where some monetary benefit to the corporation could be shown the donation was very likely to be allowed. For example, the Yam Hill Electric Company was allowed a deduction when it donated $400 to keep a local college operating when it was proved that it received each year between $535 and $663 of power and light business from the college.[31] Similarly, donations of $250 and $200 by the S. C. Toof Company were found deductible when it was shown that the recipient hospital and college gave the taxpayer much of their printing business.[32]

A donation to local educational institutions to further studies in the taxpayer's field usually qualified as a tangible benefit and therefore a legitimate business expense. Thus a newspaper was allowed to deduct the cost of establishing a school of journalism at Tulane University[33] and a cement company was allowed to deduct its contribution to Stanford University for the purpose of sponsoring university research involving the use of cement.[34]

However, a donation by a Michigan railroad company to Yale University to help establish a chair of transportation at Yale was held nondeductible on the ground that the facts on the record were not sufficient to determine the extent of benefits gained by the taxpayer — purely a question of evidentiary burden. The fact that the university was in a different part of the country may also have been a factor in determining the probable benefit.[35]

A pair of famous tax cases involved rather large deductions which were allowed in the name of legitimate business expense. The *Corning Glass Works* case[36] allowed a donation of $25,000 to a hospital while the *American Rolling Mill*[37]

27 Kekaha Sugar Co., Ltd. v. Commissioner, 13 B.T.A. 690 (1928).
28 People *ex rel.* Metropolitan Life Insurance Co. v. Hotchkiss, 136 App. Div. 150, 120 N.Y. Supp. 649 (1909).
29 HOLMES, THE COMMON LAW, 35 (1923).
30 20 B.T.A. 80 (1930).
31 Yamhill Electric Co. v. Commissioner, 20 B.T.A. 1232 (1930).
32 S. C. Toof & Co. v. Commissioner, 21 B.T.A. 916 (1930).
33 Times-Picayune Publishing Co. v. Commissioner, 27 B.T.A. 277 (1932).
34 Old Mission Portland Cement Co. v. Commissioner, 25 B.T.A. 305 (1932).
35 Michigan Central Ry. Co. v. Commissioner, 28 B.T.A. 437 (1933).
36 Corning Glass Works v. Lucas, 37 F.2d 798 (D.C. Cir. 1929), *cert. denied*, 281 U.S. 742 (1930).
37 American Rolling Mill Co. v. Commissioner, 41 F.2d. 314 (6th Cir. 1930).

case permitted a donation of $360,000 to the local community fund. Justification in *Corning Glass* came from the fact that without the local hospital the company would otherwise have had to enlarge its own infirmary service. *American Rolling Mill* allowed the contribution because of the directness of the benefit to the company employees. Company workers made up half the town's population and the donation provided 36% of the funds.

In 1937 the Morgan Construction Company's donation to the community chest was refused deduction as a necessary business expense on the grounds that the corporation only donated 1% of the funds and employed only 750 of the town's 195,000 people. The court's reasoning was that if the company had not contributed, a 1% decrease in the fund would not have had any noticeable effect on benefits likely to accrue to its workers. Withholding $360,000 in *American Rolling Mill* would have so depleted the community fund that it was deemed a necessary contribution for the benefit of the whole town. Thus the curious result that a large donation was permitted while a small one was disapproved.[38]

Also unlikely to justify a contribution is the concept of "good will," at least "good will" alone. The Old Mission Portland Cement Company, in 1934, tried to take as a deduction a donation to the community chest in the name of establishing good will in the community and thereby increasing business. The court ruled the benefit was too intangible.[39] The decision was the same when the Merchants National Bank, in 1937, attempted to take a deduction for its contribution to the community chest. The benefit was held to be too remote.[40]

The modern tax law of corporate donations is well illustrated by the 1951 case of *McDonnell Aircraft Co. v. Commissioner*.[41] There a donation to a local university for the establishment of a course in aeronautical engineering was refused as a business expense deduction. The Tax Court made clear that while the Internal Revenue Code intended to encourage corporate charity when it allowed a 5% deduction for donations in § 170,[42] it would not permit that limit to be exceeded by contributions masquerading as business expenses. Thus when McDonnell Aircraft contributed its 5% limit the court would not let them take a deduction for the additional amount. This result is not surprising in light of § 162(b)[43] which states specifically that no expenditure that could qualify as a charitable donation under § 170, but for the limitations therein, is to be taken as a business expense under § 162. The court simply applied the literal language of § 162(b) to *McDonnell*. When they found a contribution which could have qualified as a donation, were it not for the fact that the corporation had already deducted its 5% maximum, they disallowed it.

Other Cases

From time to time cases have come up which do not fit into the common fact situations; these have been decided pretty much on an *ad hoc* basis. For example, *Enos v. Harkins*,[44] in 1904, held that an incorporated church had the power to devote its general funds to a newly created parish of the same religion formed from a portion of the donor's original parish. Similarly, *State ex rel. Sorenson*[45] allowed a railroad to give free passes to clergymen and others employed by charitable organizations.

38 Morgan Construction Co. v. U.S., 18 F. Supp. 892 (D.C. Mass. 1937).
39 Old Mission Portland Cement Co. v. Helvering, 293 U.S. 289 (1934), *affirming* 69 F.2d 676 (9th Cir. 1934).
40 Merchants National Bank v. Commissioner, 90 F.2d. 223 (5th Cir. 1937).
41 16 T.C. 189, *appeal dismissed*, 191 F.2d 733 (8th Cir. 1951).
42 INT. REV. CODE OF 1954 § 170.
43 INT. REV. CODE OF 1954 § 162(b).
44 187 Mass. 40, 72 N.E. 253 (1904).
45 State *ex rel.* Sorenson v. Chicago, B. & Q. Ry., 112 Neb. 248, 199 N.W. 534 (1924).

The former case can probably be explained by the fact that the donor was not an ordinary profit making corporation. In this respect the case is not unlike the Northwestern University[46] donation which was permitted as tending to carry out the educational purpose of the university's charter. In the one case an educational purpose was promoted, in the other, a religious.

State ex rel Sorenson comes close to allowing charity as charity. In the words of the court:

> Again, we see no reason why if a railroad company desires to foster, encourage and contribute to a charitable enterprise, or to one designed for the public weal and welfare, it may not do so. . . . We see no reason why a railroad corporation may not, to a reasonable extent, donate funds or services to aid in good works.[47]

A complete picture of the changing attitude toward corporate giving cannot be obtained without giving attention to some of the noneducational, nonreligious cases. Important among these is *People ex rel. Metropolitan Life Insurance Co. v. Hotchkiss.*[48] The insurance company wished to build a tuberculosis hospital for its employees. The court allowed it on the ground that the disease was such a widespread health menace that it would be cheaper and more economical for the company to take care of its own workers than to chance losing them to the disease.

This case is another example of a court justifying its decision on the basis of the corporate benefit doctrine while putting its greatest emphasis on the humanitarian aspects of the donation. As the New York court noted:

> The enlightened spirit of the age based upon the experience of the past, has thrown upon the employer other duties [apart from merely paying a salary], which involve a proper regard for the comfort, health, safety and well-being of the employé. A corporation may not only pay its employé the actual wage agreed upon, but may extend to him the same humane and rational treatment which individuals practice under like circumstances.[49]

Even those cases which ruled against a particular instance of corporate philanthropy would usually qualify their statement to some degree. An example is the celebrated case of *Dodge v. Ford Motor Co.*,[50] where Henry Ford proposed to put all surplus beyond the 5% monthly dividend back into the company. This would have benefited the company employees and enabled Ford to cut the price of its cars so that more people could afford to own them. Though the company contended this was good business practice the court refused to allow it and ruled in favor of the stockholders in the derivative action. The court did, however, make a distinction between "an incidental humanitarian expenditure of corporate funds for the benefit of the employee . . . and a general purpose and plan to benefit mankind at the expense of others. . . ."[51] The former would be permitted, the latter would not.

A step toward official approval of corporate philanthropy was taken in 1936 when Congress authorized corporations to take as much as a 5% tax deduction for donations made to various types of charitable and public welfare organizations.[52]

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46 Northwestern University v. Wesley Memorial Hospital, 290 Ill. 205, 125 N.E. 13 (1915).

47 State *ex rel.* Sorenson v. Chicago B. & Q. Ry., 112 Neb. 248, 199 N.W. 534, 537 (1924).

48 136 App. Div. 150, 120 N.Y. Supp. 649 (1909).

49 *Id.* at 651.

50 204 Mich. 459, 170 N.W. 668 (1919).

51 *Id.* at 684.

52 Revenue Act of 1936, ch. 69, § 23(q), 49 Stat. 1661. Applicable sections now appear in the 1954 Code as §§ 162(b) and 170. § 170(c)(2) designates as deductible contributions to any "corporation, trust or community chest, created and organized in the United States, any state or territory, or any possession of the United States, organized and operated exclusively for religious, charitable, scientific, literary or educational purposes, or for the prevention of cruelty to children or animals. . . ."

This, it seemed, would stem the flood of tax cases that were so prevalent in the 1920's and 1930's, particularly with the inclusion of § 162(b) forbidding the taking of any donation as a business expense if it could have otherwise qualified as a charitable donation.[53] However, cases continued to arise when corporations tried to qualify a donation as a business expense where the Commissioner held it to be a charitable contribution; the *McDonnell* case is the prime example of this. One factor producing this litigation was the absence, in most states, of statutes permitting corporate donations to charity.

Cases where deductions were allowed in spite of § 162(b) include *Fairmont Creamery*,[54] where the company donated $200 to a local college ostensibly to retain its $3,000 yearly business and *Willcuts v. Minnesota Tribune Co.*,[55] where a donation of $208.32 to a local college was allowed as a legitimate business expense to retain advertising revenue from the college amounting to $444.45.

Up to this point the cases analyzed — both tax and otherwise — have fallen into certain broad categories. These include, first, cases providing some employee benefit; second, cases involving donations to schools, colleges and hospitals to further some activity in which the company has an interest and third, contributions made either to retain business or in the name of advertising and good will.

Generally the "employee benefit" donations were held valid if it could be shown that conferring the benefit was necessary to retain employee good will or provide a church, school or other facility necessary to the workers.[56] Contributions to colleges, universities, and hospitals usually depended for justification on the recipient being a local institution or one which would use the donation to further a course of study pertaining to the donor's business.[57] Contributions to retain business were generally held valid whereas gifts in the name of advertising and good will tended to be too "remote" and "intangible."[58]

Statutory Developments

In 1948, 13 states[59] had provisions allowing corporate philanthropy; in 1961, all but six states[60] have such legislation. If a starting point had to be ascertained for this "statutory era" it would probably be 1948. In that year the American Bar Association formulated its model provision authorizing corporate charity in the name of charity, and unconnected with benefits to the corporation. The model provision, now § 4(m) of the Model Business Act read simply: "Every corporation shall have the power to make donations for the public welfare or for charitable, scientific or educational purposes; and in time of war to make donations in aid of war activities."[61]

This was rapidly followed by a number of books,[62] law review articles,[63] and

53 See INT. REV. CODE OF 1954, § 162(b).
54 Fairmont Creamery Corp. v. Helvering, 89 F.2d 810 (D.C. Cir. 1937).
55 103 F.2d 947 (8th Cir. 1939).
56 See, *e.g.*, People *ex rel.* Metropolitan Life Insurance Co. v. Hotchkiss, 136 App. Div. 150, 120 N.Y. Supp. 649 (1909).
57 See, *e.g.*, Armstrong Cork Co. v. Meldrum Steel Co., 285 Fed. 58 (W.D.N.Y. 1922).
58 See, *e.g.*, Killian v. Commissioner, 20 B.T.A. 80 (1930); Yamhill Electric Co. v. Commissioner, 20 B.T.A. 1232 (1930) where the contributions were allowed as necessary to retain business. *But see* J. A. Majors v. Commissioner, 5 B.T.A. 260 (1926) where the donation was held not deductible as a necessary business expense, the benefit being too remote.
59 Colorado, Maryland, Massachusetts, Michigan, Missouri, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Tennessee, Texas, Virginia.
60 Arizona, Idaho, Montana, South Carolina, South Dakota, Wyoming.
61 MODEL BUS. CORP. ACT § 4(m).
62 BERLE, 20TH CENTURY CAPITALIST REVOLUTION (1954); BERLE & MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1948).
63 Dyer, *The Legality of Corporate Giving to Churches*, 23 U. OF KAN. CITY L. REV. 239 (1954); *What's New In Corporation Law*, 8 BUS. LAW 22 (1953); Bell, *Corporate Support of Education: The Legal Basis*, 38 A. B. A. J. 119 (1952); De Capriles and Garrett, *Legality of Corporate Support to Education: A Survey to Current Developments*, 38

general interest articles[64] urging the necessity of allowing corporations to do their share for charity and public welfare.

Twenty-eight jurisdictions have adopted the model provision or a recognizable variation of it. The chart following sets out the major provisions of the state statutes.[65]

It might be noted generally that 41 states provide specifically for grants to educational institutions whereas only 18 specifically mention grants to religious bodies.[66] However, even without specific mention of religious institutions, it is not unlikely that such a donation would be upheld even in a state where donations to religious groups are not specifically authorized. Nearly every statute includes some general category such as "charitable," "philanthropic," or organizations for the "general welfare" into which religious groups could be placed without straining the meaning of the legislation.[67]

A. B. A. J. 209 (1952); Bleickin, *Corporate Contributions to Charities: The Modern Rule,* 38 A. B. A. J. (1952); Navarro, *Corporate Authority to Contribute to Charity,* 26 PHIL. L. J. 187 (1951); Cousens, *How Far Corporations May Contribute to Charity,* 35 VA. L. REV. 401 (1949); Garrett, *Corporate Donations to Charity,* 4 BUS. LAW. 28 (1948).

64 *Corporate Profits and Campus Budgets,* Fortune, Dec. 1952; Olds, *Should Business Support the College,* Fortune, Dec. 1951; Sloan, *Big Business Must Help Our Colleges,* Colliers, June 2, 1951.

65 ALA. CODE tit. 10, § 21 (56) (16) (Supp. 1959); ALASKA COMP. LAWS ANN. § 36 — 2A — 12(m) (Supp. 1957); ARK. STAT. ANN. § 64-112 (Supp. 1957); CAL. CORP. CODE § 802(g) (1955); COLO. REV. STAT. § 31-28-1(13) (Supp. 1960); DEL. CODE ANN. tit. 8 § 122(9) (1953); D.C. CODE § 29-904(m) (Supp. 1960); FLA. STAT. § 608.13(13) (1959); GA. CODE ANN. § 22-728 (Supp. 1958); HAWAII REV. LAWS § 172-26 (1955); ILL. ANN. STAT. ch. 32, § 157.5(m) (Smith-Hurd 1959); IND. ANN. STAT. § 25-211(b) (1960); IOWA CODE ANN. § 496A.4(13) (Supp. 1960); KAN. GEN. STAT. § 17-3009 (Supp. 1957); KY. REV. STAT. ANN. § 271.125 (13) (1955); LA. REV. STAT. § 9-2280 (Supp. 1960); ME. REV. STAT. ANN. ch. 53 § 16 (1954); MD. ANN. CODE art. 23 § 9(10) (1957); MASS. ANN. LAWS ch. 155 § 12, § 12A, § 12C (1959); MICH. STAT. ANN. § 21.10(b) (Supp. 1959); MINN. STAT. ANN. § 300.66, § 300.67, § 300.68 (Supp. 1960); MISS. CODE ANN. § 5325. 7 (1956); MO. REV. STAT. § 351.385(12), (15) (1957); NEB. REV. STAT. § 21-1, 165 (1954); NEV. REV. STAT. § 78.070(7) (Supp. 1960); N.H. REV. STAT. ANN. § 294.4 (8) (1955); N.J. STAT. ANN. § 14:3-13.1, 13.2, 13.3, 13.4 (Supp. 1960); N.M. STAT. ANN. § 51-2-2(8) (1953); N.Y. GEN. CORP. LAW § 34, § 35 (Supp. 1961); to be replaced as of April 1, 1963 by N.Y. BUS. CORP. LAW § 202 (a) (12); N.C. GEN. STAT. § 55-17(a)(6) (Supp. 1960); N.D. CENTURY CODE ANN. § 10-1904(13) (1960); OHIO REV. CODE ANN. § 1701.13(d) (Page Supp. 1960); OKLA. STAT. ANN. tit. 18, § 1-19(11) (1953); ORE. REV. STAT. § 57.030(13) (Supp. 1959); PA. STAT. ANN. tit. is § 716, 2852-302(16) (1958); P.R. LAWS ANN. tit. 14, § 1202(9) (1957); R.I. GEN. LAWS ANN. § 7-9-8, 9, 10, 11 (1956); TENN. CODE ANN. § 48-705 (1955); TEX. BUS. CORP. ACT art. 2.02(14) (1956); UTAH CODE ANN. § 16-2-14(8) (Supp. 1961); VT. STAT. ANN. tit. 11, § 107 (1958); VA. CODE § 13.1-3(m) (Supp. 1956); WASH. REV. CODE § 23.70.010, .020 (Supp. 1958); W. VA. CODE ANN. § 3015 (1955); WIS. STAT. ANN. § 180.04(12) (1957).

66 The reluctance to get involved with religion is illustrated by the attitude of the American Bar Association's section on corporation, banking and business law which met in 1952 to discuss the model business act. When asked why the word "religious" was not included in the model provision, the chairman replied, "In adopting the model act, the committee felt that was a field we ought not invade at the outset. . . ." He then pointed out that the Council of Churches of Christ had requested them to include it but they had not passed on the question. It never has been included. *What's New In Corporate Law,* 8 BUS. LAW. 22, 27 (1953).

67 See Dyer, *The Legality of Corporate Giving to Churches,* 22 U. OF KAN. CITY L. REV. 239 (1954) for a detailed analysis of corporate aid to religious groups. The subject has received surprisingly little treatment, probably because it has never been a major source of litigation. Should churches ever become heavily dependent on corporate giving it will be interesting to see what social pressures, if any, will be brought to bear.

State	Educational Provision	Religious Provision	Limit on Amount	Adopted Model Act[68] or variation thereof*
Alabama	X			X
Alaska	X			X
Arizona	No	Provision		
Arkansas	X			X (V)
California	X			X
Colorado	X			X
Connecticut	X			X
Delaware	X			X
Dist. of Columbia[69]				
Florida	X			X (V)
Georgia	X			X
Hawaii [70]				
Idaho	No	Provision		
Illinois	X	X		X
Indiana [71]	X	X	X	
Iowa	X	X		X (V)
Kansas	X	X		
Kentucky	X	X		X (V)
Louisiana [72]	X	X		
Maine	X			X
Maryland	X	X	X	
Massachusetts	X		X	
Michigan	X	X		
Minnesota	X	X		
Mississippi	X	X	X	X (V)
Missouri [73]				
Montana	No	Provision		
Nebraska [74]				
Nevada	X			X
New Hampshire	X			X
New Jersey [75]	X		X	
New Mexico	X			X
New York [76]	X			
North Carolina	X	X		
North Dakota	X			X
Ohio	X			X
Oklahoma [77]	X			
Oregon	X			X
Pennsylvania	X	X		X (V)
Puerto Rico	X		X	X (V)
Rhode Island	X		X	
South Carolina	No	Provision		
South Dakota	No	Provision		
Tennessee [78]			X	
Texas	X			X
Utah	X	X		X (V)
Vermont	X	X	X	X (V)
Virginia	X	X	X	
Washington	X	X	X	
West Virginia	X	X		
Wisconsin	X	X		X (V)
Wyoming	No	Provision		

* (V) indicates a variation of the Model Act's charitable donations clause. Variations from the "time of war" provision of § 4(m) are not categorized in the chart.

Current Status of the Law

Following the statutory developments, superimposed on a gradually liberalized common law, *A.P. Smith Mfg. Co. v. Barlow*,[79] is now regarded as the restatement of the modern law of corporate donations.

Smith was brought in New Jersey, an ideal state in light of *Zabriskie v. Hackensack & N.Y. Ry. Co.*[80] *Zabriskie* held that a corporation's charter could not be changed by legislative enactment even when the legislature reserved the right to do so, unless *all* stockholders concurred. This meant that, as to existing corporations, the power to make charitable contributions could not be conferred thereon without complete stockholder approval.[81]

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68 Of the 26 states that adopted the model provision or a recognizable variation of it, 9 including California, Connecticut, Delaware, Georgia, Maine, Nevada, New Hampshire, New Mexico, and Ohio adopted it without the "time of war" provision while Alabama, Alaska, Colorado, Illinois, North Dakota, Oregon, and Texas included the provision which allows donations in time of war. Some of the states have a "time of war" provision but in a separate section, unrelated to the corporate donations provision. Florida makes no mention of the "general welfare" while Illinois, Iowa, Mississippi, Utah, Wisconsin, and one Pennsylvania statute simply add the word "religious" to the model act. Kentucky uses "religious" in place of "charitable" and Vermont and Virginia add "religious" as well as other categories such as "literary," "cultural." Arkansas adopted the model act but chose to enumerate the types of corporations to which it applied, while Mississippi limits donations to annual earnings and treats them as operating expenses. Tennessee, not a model provision state, also treats donations as operating expenses.

69 The District of Columbia simply authorizes contributions to "charitable organizations" as well as providing for donations to war activities.

70 Hawaii is the only state that requires every donation to be authorized at a stockholders meeting. They require that a majority vote of the shareholders approve the donation. Hawaii allows contributions "for charitable purposes or to eleemosynary institutions" as well as providing for pensions and similar employee allowances.

71 Indiana is unique in that it incorporates the Internal Revenue Code into its statute by reference, allowing as a permissible contribution, any donation that can qualify as a deduction from gross income thereunder.

72 Louisiana along with Maryland, Minnesota, North Carolina, Washington, and West Virginia have adopted provisions based generally on § 170 of the Internal Revenue Code, allowing donations to the same groups enumerted as permissible grantees in § 170. Pennsylvania has a statute like this, applying to special types of corporations as well as one patterned on the model code which applies to corporations generally.

73 Missouri's statute allows contributions "to any corporation organized for civic, charitable or benevolent purposes . . . or to the community chest or community fund" as well as to war activities.

74 Nebraska provides for contributions to: "charitable undertakings or enterprises and instrumentalities for the preservation and betterment of social and economic conditions in the territory in which it operates."

75 New Jersey, Rhode Island, and Vermont while placing limits on the amount of contributions also provide that this limit may be exceeded with stockholder approval. New Jersey also specifies that the donation must in the judgment of the directors, "contribute to the protection of the corporate interests." A similar requirement appears in the New York statute but seems to apply to donations to instrumentalities, in states where the corporation does not do business.

76 New York in 1961 passed a new business corporations law to go into effect April 1, 1963. According to § 202(a) of this law corporations may, "make donations, irrespective of corporate benefit for the public welfare or for community fund, hospital, charitable, educational or similar purposes, and in time of war or other national emergency in aid thereof."

77 Oklahoma requires that donations either benefit the corporation *or* the public interest.

78 Tennessee's statute allows "gifts, donations or contributions for charitable purposes or to charitable enterprises and undertakings. . . . "

79 13 N.J. 145, 98 A.2d 581, *appeal dismissed*, 346 U.S. 861 (1953).

80 18 N.J. Eq. 178 (Ch. 1867).

81 *Zabriskie* concerned a railroad that was chartered to run from Paterson to Hackensack. In 1861 the state legislature amended the company's charter so that it could extend its line twelve miles further and join the Erie Railroad. When a minority stockholder objected the action was enjoined. The court analogized to the case of Natusch v. Irving, 2 Coop. I. Cott 358 (1824) which had held that a partnership could not change its business

If this line of reasoning were followed it would present a formidable barrier to encouraging corporate philanthropy. The traditional approach was the enactment, by a state, of a general statute providing that all corporations were authorized to make charitable donations, the intent being to include corporations chartered before the enactment of the statute as well as those created afterwards.

It was considered possible to do this because most states had in existence a "reserve law" to circumvent the impairment of contracts problem that grew out of *Dartmouth College v. Woodward.*[82] The usual reserve law provided that the jurisdiction reserved to itself the power to amend all corporate charters in the public interest.[83] This was interpreted to mean that, because the state had so reserved the right to alter corporate charters, the right existed by implication in any charter granted after the passage of the reserve law.[84] This being so, states could alter corporate charters and confer the power to make charitable contributions.

The difficulty was that the jurisdictions which followed *Zabriskie* didn't agree with that rationale. *Zabriskie* took the position that the corporate charter constituted three contracts: one between the corporation and the state, one between the corporation and its stockholders and one between the stockholders themselves. This concept of three contracts was not unusual. Where *Zabriskie* differed was that it made a distinction between the corporation-state contract and the other two. It held that the state could constitutionally alter the contract between itself and the corporation but that it could not tamper with the corporation-stockholders contract or the stockholders *inter se* contract which supposedly would be the case if it could grant corporations the power to make donations.[85]

Zabriskie was challenged in *Smith* and at least as far as corporate donations are concerned, was discarded.[86] *Smith* involved a declaratory action questioning the propriety of a donation of $1,500 to the general fund of Princeton University. New Jersey, then as now, had a typical corporate donations statute passed in 1930 and amended in 1950.[87] But rather than base its decision on the statute the court held the statute to be mere legislative approval of a right the corporation could properly be said to have under the common law, that is, the right to make reasonable contributions to charity.

Concerning *Zabriskie* the court pointed to New Jersey cases which had nominally followed the decision while, at the same time, allowing the state to alter a corporate charter.[88] The court said, "It seems to us that the public policy supporting the statuatory enactments under consideration is far greater and the

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purpose without unanimous consent of the partners despite parliamentary authorization to do so. The court said that the passage of a reserve law by the state was not intended to invalidate this principle and that it applied to corporations as well as to partnerships.

82 17 U.S. (4 Wheat.) 518 (1819). The *Dartmouth College Case* held that corporate charters were protected by the impairment of obligations clause of the Constitution (U.S. CONST. art. I, § 10). Thus, if the legislature attempted to alter a corporate charter by legislative pronouncement it was acting unconstitutionally. Reserve laws circumvented this difficulty by including as a part of every corporate charter the right of the legislature to alter it in the public interest. *See Corporate Donations: Common Law, Statutory, and Constitutional Implication,* 29 IND. L. J. 295 (1954) on the constitutionality of state reserve laws. Also, Lattin, *A Primer of Fundamental Corporate Changes,* 1 WES. RES. L. REV. 3 (1949).

83 See *e.g.,* IND. ANN. STAT. § 25-404(b) (1960).

84 *See* DeCapriles and Garrett, *Legality of Corporate Support to Education: A Survey of Current Developments,* 38 A.B.A.J. 209 (1952).

85 See note 84, *supra.*

86 The court attained this result by citing numerous cases in New Jersey where the contract between the corporation and its stockholders was altered in the public interest, and adhered to them rather than *Zabriskie. E.g.,* Berger v. U.S. Steel Corp., 63 N.J. Eq. 809, 53 Atl. 68 (1902). In Re Collins-Doan Co., 3 N.J. 382, 72 A.2d 159 (1949).

87 N.J. STAT. ANN. §§ 14:3-13.1-13.4 (Supp. 1960).

88 See note 86, *supra.*

alteration of pre-existing rights of stockholders much lesser than in the cited cases sustaining various exercises of reserve power."[89]

Just how far the court really did go in *Smith* is difficult to assess. That is because the court gave the impression that it would consider a sufficient corporate benefit to be the contribution it made to society, thus making benefit to society and benefit to the corporation almost synonomous. But the court did not flatly say that and a court in good conscience could ignore the inferences and confine *Smith* to its facts.

So while *Smith* comes very close to going all the way and saying that a company does not have to get any return at all, it appears that the "benefit" concept cannot be discarded entirely; the benefit may be very remote but it is still a factor to be considered.

The next and last important case arose five years later in Utah, another state which appeared to follow *Zabriskie.* The Union Pacific Railroad had created a charitable fund within the company and then wished to make a donation to it. When a stockholder questioned the action the company sought a declaratory judgment to determine the legality of its act. The lower court struck down the gift only to be reversed by the Utah Supreme Court.[90]

The court's opinion, like *Smith,* spoke in glowing terms of the need for corporate philanthropy and quickly endorsed the implied, incidental power of the corporation to make a reasonable charitable contribution. However, the case does not dispose of the old doctrines. First, the court refused to rule on the basis of the Utah corporate donations statute. The court said it was against the policy of the state to declare retroactive any law not specifically designated as retroactive.[91] A second problem is that the court refused to go beyond *Smith* and declare unequivocally that any reasonable corporate contribution is permissible at common law without recourse to a corporate benefit.[92] Finally, the dissenting judge in his summation of the majority opinion gave the impression that the majority inferred that no enabling statute could be applied retroactively, whereas the holding was that this particular statute could not be applied retroactively because of the Utah rule against retroactive applications of the law.[93]

Probable Developments

In spite of their objections to *Union Pacific,* proponents of corporate philanthropy cannot deny that modern law has treated corporate giving generously. State statutes now generally permit it; the Internal Revenue Code allows corporations up to a 5% deduction for contributions made to charity[94] and the clear

89 98 A.2d at 590.

90 Union Pacific Ry v. Trustees, Inc., 8 Utah 2d 101, 329 P.2d 398 (1958).

91 UTAH CODE ANN. §§ 68-3-3 (1953) reads, "No part of these revised statutes is retroactive, unless expressly so declared."

92 As a matter of fact it doesn't go quite as far as *Smith* because the court justifies contributions only, "if they appear reasonably designed to assure a present or foreseable future benefit to the corporation." It softens the effect of this statement, however, by adding that, management decisions in such matters should not be rendered impotent unless arbitrary and unreasonably indefensible, or unless countermanded or eliminated by action of the stockholders at a proper meeting. Union Pacific Ry. v. Trustees, 8 Utah 2d 101, 329 P.2d 398, 402 (1958). See Gibson, *Corporate Contributions to Charity and Enabling Legislation,* 14 BUS. LAW. 434 (1959) and *Corporate Power to Make Charitable Contributions Further Liberalized,* 6 UTAH L. REV. 270 (1958).

93 See note 91, *supra.*

94 Besides the 5% corporate deduction authorized by the Internal Revenue Code of 1954, § 170, the National Banking Act, 54 Stat. 261, 12 U.S.C. § 24 (8) permits national banks to contribute to, "community funds or to charitable, philanthropic or benevolent instrumentalities conducive to public welfare such sums as its board of directors may deem expedient and in the interests of the association, if it is located in a state the laws of which do not expressly prohibit state banking institutions from contributing to such funds and instrumentalities.

trend of cases decided on common law principles — *Smith* and *Union Pacific,* for example — is favorable.

Against this background it appears that any corporate donation of a reasonable amount to a reputable organization has an excellent chance of being upheld, particularly if it is one of the types of organizations specified in the statute, the most common ones being "charitable," "educational," and "scientific."

As to those groups less frequently mentioned specifically, such as religious, civic, and literary organizations, it is still very possible that a donation to such a group could be justified by including them under the more general category which is designated, such as "charitable organizations" or "organizations for the general welfare."

Questions remain in the law of corporate donations: are the reserve statutes constitutional?[95] If not, what are the possibilities of justifying donations under the more powerful police power of the state?[96] How much of a benefit, if any, must the corporation receive to satisfy the now emasculated corporate benefit rule,[97] and should there be limits on the amount that may be donated? Where there are no limits what will happen if the directors authorize an unreasonable contribution or one to a "pet" charity?[98]

These are all fertile areas which, given the proper situations, could develop into litigation. But, it is submitted, they are not likely to do so. First, corporate philanthropy is no longer being challenged in the courts.[99] Second, while the courts have refused to rule unequivocally on a number of problems such as the application of the enabling statutes, it is because they can reach the same end by other means and do not wish to break new ground if they can avoid it.[100]

Classen J. Gramm

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95 All indications favor constitutionality. For instance, Looker v. Maynard, 179 U.S. 46, 54 (1900) speaking on a closely related problem stated:

> Remembering that the Dartmouth College Case [which was the cause of the general introduction into the legislation of the several states of a provision reserving the power to alter, amend or repeal acts of incorporation] concerned the right of a legislature to make a change in the number and mode of appointment of the trustees of a corporation, we cannot assent to the theory that an express reservation of the general power does not secure to the legislature the right to exercise it in this respect.

Also Polk v. Mutual Reserve Fund Life Ass'n of N.Y., 207 U.S. 310 (1907) and Veix v. Sixth Ward Bldg. & Loan Ass'n of Newark, 310 U.S. 32 (1940).

96 Should it be necessary to justify statutory contribution provisions on the basis of the police power of the state, the *Smith* Court hints that this would not be impossible. *See Corporate Donations: Common Law, Statutory and Constitutional Implications,* 29 IND. L. J. 295 (1954).

97 *Smith* paved the way for discarding the corporate benefit rule altogether only to have *Union Pacific* reinstate it to a degree. The position now seems to be, if any kind of benefit can be found to the company, even if only good will, the donation will most probably be allowed. Whether a contribution would be permitted where the corporation would receive no tangible benefit whatever, for instance if the contribution were made anonymously, or as in *Michigan Ry. Co. v. Commissioner* if it were made to an institution far from the donor's place of business, then it depends on which rule is adopted. The *Smith* case gives the impression that such a contribution would be permissible; *Union Pacific* seems to indicate it would not.

98 The court in *Smith* infers that only "reasonable" contributions both as to amount and recipient would be countenanced. Should any instances of unreasonable action by the directors come up, it is likely that the courts would clamp down immediately. *But see, Corporation Giving: Some Legal Aspects,* 8 RUTGERS L. REV. 527 (1954) for suggestions as to possible limitation on contributions in the interest of protecting rights of minority stockholders.

99 See note 15 *supra.*

100 *Smith* is the perfect example; the court all but admitted it was making new law but "indirectly through the molding of old forms . . . " 13 N.J. 145, 98 A.2d 581, 586 (1953). at 586 (1953).