PLANNERS' FORUM

A Basic Guide to Corporate Philanthropy

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A business has reached a point where it wants to "give back." It's had a year better than it expected in this economy, and it knows the community could use a helping hand. How should the business go about its philanthropy? What should you, as a charitable gift planner, know before approaching a business for charitable gift? This article briefly discusses three basic methods by which a for-profit corporation can pursue charitable giving: direct giving to charity, a company foundation, and a donor advised fund.

Direct Giving[1]

Giving directly to charity is probably the simplest method by which a corporation can give back to the community. To deduct its gift as charitable, the corporation should ensure that its donee is tax-exempt under Section 501(c)(3) [2] and organized in the United States. (Gifts directly to foreign entities are generally not deductible.[3] Also, the grantee's designation as "nonprofit" is insufficient. Many nonprofits, such as chambers of commerce or social welfare organizations, are not eligible to receive charitable donations.)

Deductible amount. If a corporation gives property instead of cash, the amount it may deduct depends on several factors, including the type of property being donated, how long the corporation has held it, the donor's basis, whether the donee will use the gift in its exempt purposes, and whether the recipient is a public charity or a private foundation, both subcategories of Section 501(c)(3). Generally, the amount eligible to be deducted will be larger if the donee is a public charity, if the donee will use the property in its exempt purposes (as opposed to selling it for cash, for example), and if the donor can classify the property as long-term (as opposed to short-term) capital gain property. Regardless, a corporation may only deduct up to 10% of its taxable income each year in the form of charitable contributions, but can carry forward for up to five years amounts not deducted for possible later use. Gifts of services (such as the volunteer time of employees) can be an effective and visible way of giving back, but are not deductible.

Purpose. A corporate donor can make a gift to a charity with no direction as to how the funds must be spent. These "unrestricted funds" are particularly useful, as the recipient charity can decide how to use

them. Many donors require a recipient charity to spend the funds for a particular charitable purpose (for example, to help cancer patients or needy families). If the charity accepts the gift with restrictions, state charitable trust law generally requires that the gift be spent for those purposes.

Trap for the unwary. Sometimes, a donor wishes to condition its gift on the recipient re-granting some of the gift to a particular person or charity. The risk is "earmarking" - if the recipient charity has no "discretion and control" as to whom it may pay the funds, the Internal Revenue Service may view the gift as a direct transaction between the donor and the charity's grantee.[4] If the charity's grantee is either an individual or is not a domestic Section 501(c)(3) charity, the corporation cannot take a charitable deduction at all. In short, "earmarking" can negate the tax benefit of the gift.

Receipts and substantiation. To take any deduction for a gift of cash, and most gifts of property, the corporation will need a receipt. Property valued at above $5000 will require an appraisal meeting certain standards. The donor may also have to complete and file IRS Form 8283.

Summary of direct giving. Direct giving is a good option for a company starting philanthropy. It can require almost no administrative costs besides the gift itself and the time involved in making the decision of what, how, and to whom to give.

Company Foundation

A corporation can also form an affiliated charity.

Setting it up. The new charity would generally be a nonprofit corporation with no stockholders (and in California, would also be a "public benefit corporation").[5] It would have articles or a certificate of incorporation filed with the state, and bylaws. The new charity would apply to the IRS for an employer identification number and for recognition of its Section 501(c)(3) status. Depending on how long the company takes to make the necessary decisions, the complexity of the charity's planned operations, and the IRS' processing time, the formation and exemption process could take from a few months to a year or longer.[6]

Depending on the state(s) in which it is organized and physically located, the new charity may also need to apply for tax-exempt status at the state level. Most state attorneys general have jurisdiction over charitable assets located in, or belonging to a charity located in, their state, and so an attorney general registration may also be required.

Like any other corporation, the new company foundation will need a Board of Directors with duties of care and loyalty to oversee the foundation's operations. Because most company foundations depend on company gifts, a company foundation typically requires the support of high-level persons within the company. As a result, as a practical matter, high-level employees usually comprise a majority or all of a company foundation's Board.

Maintenance. Like any other charity, the company foundation will need to make regular filings with governmental authorities. These may include: the Secretary of State or Department of Corporations of its state of organization; the IRS, with which it will file a Form 990-PF each year; a state tax return; a state Attorney General report; and possibly others. The foundation Board should meet regularly to oversee foundation operations, but may delegate day-to-day responsibility to a company employee or employees.

Preventing "mission drift." Most companies prefer to select (and be able to remove) the directors of its foundation. This prevents "mission drift," in which the foundation, over generations of directors that self-elect, differs from the company in its philanthropic goals. To prevent mission drift, the

company could choose to be the foundation's sole "member," a position analogous to shareholder but without ownership or profits interest, and which permits the company to select and remove directors. In California, a company can also "designate" directors of the foundation.[7]

Keeping the company and foundation separate. A company usually staffs its foundation with company employees who are considered volunteers of the foundation. These individuals wear two hats - company employee and foundation volunteer. To help insulate the company and foundation from the other's liability and prevent accidental self-dealing (discussed below), it is important for the company employee/foundation volunteer to keep her roles separate and to be clear to herself and others in what capacity she is acting. For example, in speaking with a potential grantee, the foundation staff member should be clear that he or she is communicating with the grantee as either a foundation staff person, or as a company employee.

Another separation issue is who makes grant decisions. Under corporate law, a company foundation's Board, and not the company, is responsible for foundation grant decisions. However, because the foundation depends on the company for donations and staff, the foundation's Board will justifiably seriously consider the company's *suggestion* as to a prospective foundation grantee.

Private foundation rules and self-dealing. As mentioned above, Section 501(c)(3) charities are divided into two main categories: public charities and private foundations. Most company foundations are private foundations, which are subject to much stricter rules than public charities. For example, private foundations are prohibited entirely from making certain kinds of expenditures (such as expenditures for lobbying, or grants to individuals or foreign organizations unless very specific requirements have been met); they may not invest their assets in a manner likely to jeopardize their exempt purpose; they may not, together with certain insiders, hold more than a certain percentage of the ownership of a business; they must distribute for charitable purposes at least 5% of the fair market value of the previous year's assets; they annually pay a 2% tax on net investment income; and they are subject to extremely strict rules on certain transactions with insiders, called self-dealing.

Among these rules, self-dealing presents unique issues in the context of company foundations. Section 4941 imposes a prohibitive tax on most transactions between a private foundations and its insiders, which Section 4941 refers to as "disqualified persons." ("Disqualified person" typically includes the company, as a substantial contributor to the foundation; foundation officers and directors; an owner of more than 20% of an entity that is a substantial contributor; certain family members of all the preceding; and any entity in which any of the persons described together own more than 35%.) While a disqualified person such as the company may donate cash, assets, and staff time to its foundation, *any* sale, exchange or lease between them (even one by the company to the foundation at well-below fair market value) is essentially prohibited. The company may not use a foundation asset (whether office space, furniture, or information) for its benefit. Even attempts to fairly allocate shared expenses can run afoul of the self-dealing rules. So a company considering forming a foundation must understand that a seemingly fair or logical arrangement with its foundation must first be examined to ensure it is not self-dealing. Learning the self-dealing rules well enough to spot potential problems can take significant staff time and legal fees. Many companies, to avoid any kind of self-dealing, prefer to subsidize entirely their foundations and forego all benefit except clearly-

permitted "incidental and tenuous" benefits, such as the goodwill the company earns by supporting a foundation that bears its name.

Eligible grantees. A private foundation's grantees are not equal. A domestic public charity grantee can even receive a grant with no grant agreement. By contrast, a private foundation grant to another private foundation is permitted only if the grantor exercises a specific form of oversight called "expenditure responsibility" over the grant. A private foundation wishing to make a grant to an international organization must usually either exercise expenditure responsibility or determine that the entity is a foreign equivalent of a U.S. public charity.[8] Many foundations are comfortable with expenditure responsibility, foreign public charity equivalency or both; staff must take the time, however, to learn to do them correctly. Private foundations can make grants to individuals who are needy or awards prizes recognizing past achievement; the procedures for other individual grants must be approved in advance by the IRS. (Typically, a foundation requests this approval when it applies to the IRS for recognition of exempt status; a separate ruling later can be expensive.) Private foundations can even make grants for charitable purposes to non-501(c)(3) tax-exempt organizations and for-profits, provided that the private foundation exercises expenditure responsibility over the grants.

Trap for the Unwary. Because the private foundation rules are not rules of reason and their consequences are often severe, it is difficult for someone unfamiliar with them to gauge accurately whether a proposed action raises potential tax-exempt issues or not. A company foundation must either invest significant staff time in learning these rules, hire someone with that knowledge, rely on legal counsel, or do some combination of the three.

Advantages over direct giving. A company with a surplus at the end of a fiscal quarter or year can make a gift to its foundation, take the charitable deduction in that year (up to 10% of its taxable income), and decide later how the funds should be distributed to the community. (By contrast, a direct gift requires a real-time decision about what charitable purpose and donee to fund.) Second, a separate company foundation can remind employees and the public of the company's ongoing philanthropic commitment. (By contrast, the impact of a direct gift may be more limited in strength or duration.) Last, a company foundation under certain circumstances can, from funds given by and deductible to the company, make charitable grants to individuals, foreign entities, nonprofits that are not Section 501(c)(3) tax-exempt, and even for-profits. (By contrast, a company generally cannot take a charitable deduction for direct gifts to any of these.)

Disadvantages over direct giving. The main disadvantage of a company foundation is the time, money, and effort required to start it and maintain it in compliance with the private foundation rules. Also, because charitable deductions for non-cash gifts to public charities can, depending on the asset donated, be greater than for such gifts to private foundations, a company may in certain cases be able to deduct a greater amount for a gift to a direct public charity grantee than its own private foundation.[9]

Summary of giving via a private foundation. A company foundation can provide a visible reminder to company employees and the public of the company's support of the community. The time and money required to start and to run a company foundation properly can be significant. Companies considering giving back by setting up an affiliated foundation should learn about the private foundation rules, and discuss the costs and benefits of philanthropy via a private foundation with counsel and other companies who have already taken this route.

Donor Advised Fund

A third option for a company wishing to give back to the community is a donor advised fund.

Donor advised funds generally. A donor advised fund is a separate fund (though not a separate legal entity) created and held at a public charity, often a local community foundation or the charitable affiliate of a financial services provider. The company contributes funds or assets to the public charity, which allocates them to the donor advised fund. The company can take a public charity deduction, to a maximum of 10% of its taxable income, in the year in which it makes its contributions, because the donated assets are the property of the public charity. The company, or someone appointed by the company (such as its CEO, for example), retains the right to advise or recommend charitable grants from the donor advised fund from time to time. Usually, the donor can name the fund ("The Company Fund" or "The Company Foundation") and even recommend how those funds will be invested. For its service, the charitable owner of a donor advised fund, called the sponsoring organization, typically deducts some small percentage of the fund assets or contributions received.

Discretion and control. The company can take a deduction in the year in which it makes its gift to the sponsoring organization, regardless of when the funds or assets are granted out, because the public charity has "discretion and control" over those assets. In other words, the public charity, which is the legal owner of the funds, need not heed the advice of the donor. As a practical matter, however, the public charity will do so where possible.

Eligible grantees. Gifts from a donor advised fund *can* be made to most public charities, their foreign equivalents, and another donor advised fund. Gifts from a donor advised fund can also be made to any other grantee for charitable purposes, *provided* that the sponsoring organization exercises expenditure responsibility over the grants. A donor advised fund cannot make grants to individuals.[10] As a practical matter, some sponsoring organizations are willing to exercise expenditure responsibility and perform foreign public charity equivalency analyses, and some are not. A company wishing to make overseas grants, for example, should specifically discuss this intention with the potential sponsoring organization before setting up the fund.

No benefit to donors. Section 4967 essentially prohibits a grant from a donor advised fund that "results in" the donor, advisor (if different), certain members of their family, and certain entities related to them "receiving, directly or indirectly, a more than incidental benefit as a result of such distribution". Section 4958 heavily taxes any grant, loan, compensation or other similar payment from a donor advised fund to a donor advised fund's donors, advisors, family members, and certain entities controlled by them.

As of this writing, the IRS has issued no guidance (including regulations) on either of these rules. Most sponsoring organizations of donor advised funds, however, require an advisor to attest that any grant advised by him will not result in a benefit to him or related persons or entities, that the grant will not satisfy a pledge by him, and that the grant funds will not be used to pay, even in part, for anything for which he would receive a return benefit.

Traps for the unwary. A company that creates a donor advised fund must understand that it gives up legal control and ownership of the assets once given to the sponsoring organization. Gifts from the fund to charities it suggests are "made possible by" the company, but the company has no direct relationship to the ultimate grantee. Direct attempts to exercise control over how grant funds are spent by the grantee of the sponsoring organization could make the grants

appear earmarked directly from the company to the ultimate grantee.

In addition, as of this writing, the IRS has yet to issue regulations on the donor advised fund statutes discussed. Therefore, a company could take a position arguably permissible under existing law (for example, by advising a grant that yields a very small but tangible benefit to it) that future regulations could ultimately prohibit.

Advantages over direct giving. A company with a surplus at the end of a fiscal quarter or year can make a gift to its donor advised fund, take its deduction in that year (subject to the 10% limit), and decide later how the funds should be spent. (By contrast, a direct gift requires a real-time decision about what charitable purpose and donee to fund.) The sponsoring organization of a donor advised fund can, from funds given by and deductible to the company, make charitable grants to foreign entities, nonprofits that are not Section 501(c)(3) tax-exempt, and even for-profits, provided the sponsoring organization is willing to exercise expenditure responsibility over these grants. (By contrast, a company generally cannot take a charitable deduction for direct gifts to any of these.)

Disadvantages over direct giving. The chief disadvantage of a donor advised fund is the donor legally has no control over assets once contributed; the fund holder could choose not to honor the recommendation of the fund advisor. (By contrast, in a direct gift, the company retains control over the assets until the gift is made.) Also, a sponsoring organization deducts a small percentage of the fund assets or contribution as a fee; a direct gift would not carry this administrative expense.

Advantages over a private foundation. The cost, time, and effort required to set up and maintain a donor advised fund are a fraction of that required to set up and maintain a private foundation. Non-cash gifts to a donor advised fund are eligible to receive the more favorable public charity deduction.

Disadvantages over a private foundation. Through its selection of directors of its affiliated foundation, a company can retain a great deal of control over the assets held by the foundation. By contrast, a company loses legal control of any assets donated to the donor advised fund.

Summary of donor advised funds. Donor advised funds can be an effective philanthropic vehicle for a company beginning philanthropy, as they do not require a significant investment of time, money, or effort, and some sponsoring organizations are even willing to help educate their donors about philanthropy and assist them in clarifying their philanthropic objectives. Even though sponsoring organizations typically honor the donor's recommendation where possible, some donors may not be comfortable with the idea of not having legal control of assets contributed.

Conclusion

A business wishing to give back to its community has multiple options about how to conduct its philanthropy. Its best choice will depend on what kinds of organizations it wishes to support, its resources, and its goals. Many companies use some combination of direct giving, an affiliated foundation, and a donor advised fund to maximize the advantages and disadvantages of each.

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Corporate Philanthropy: Comparing Three Philanthropic Vehicles

Recipient of Gift	By Direct Giving	By Company Foundation	By Donor Advised Fund
Domestic public charities	Yes	Yes	Yes
Private foundations	Yes	Yes, with expenditure responsibility	Yes, with expenditure responsibility
Foreign charities	Not usually deductible	Yes, with expenditure responsibility or equivalency	Yes, with expenditure responsibility or equivalency
Individuals, for scholarships	Not deductible	Yes, after IRS approval of procedures	No
Individuals, for need (i.e., helping the poor, the sick)	Not deductible	Yes	No[11]

Special Circumstance	Direct Giving	Company Foundation	Donor Advised Fund
Event sponsorships	Company can pay for and deduct, subject to corporate sponsorship regulations	If foundation pays, caution required to ensure no self-dealing (improper benefits back to company)	Will depend on circumstances; forthcoming guidance should provide some clarity
Donation of company products	Yes	Private foundation can grant out, but company might have received better deduction by giving directly to a public charity	Will depend on circumstances; forthcoming guidance should provide some clarity
Disaster relief for company employees	Not deductible as charitable, but may receive favorable income tax treatment to employees - see IRS Publication 3833	Yes, if certain specific circumstances are met - see IRS Publication 3833	Yes, if certain specific circumstances are met - see IRS Publication 3833

[1]This article discusses a company's ability to deduct a gift as a charitable contribution under Section 170 of the Internal Revenue Code. In certain circumstances, it may be possible for a company to treat a particular gift to charity as a deductible business expense under Section 162.

[2]Unless otherwise indicated, all statutory references in this article are to the Internal Revenue Code.

[3]A domestic "Friends of" organization to the foreign charity may solve this problem; a discussion of "Friends of" organizations is beyond the scope of this article.

[4]"Earmarking" differs from placing purpose restrictions on a gift. In a purpose restriction, the charity may decide to whom to give the funds.

[5]Corporations are much more commonly used than trusts due to the lower fiduciary standards and clearer rules of governance.

[6]If applied for within 27 months of formation and granted by the IRS, Section 501(c)(3) status will be retroactive to the date of formation.

[7]The foundation's reliance on the company for funding might prevent mission drift, but the two methods discussed assure the company's power to prevent it.

[8]See Betsy Buchalter Adler and Stephanie L. Petit, Equivalency or Expenditure Responsibility? A Guide in Plain English, *International Dateline*, Issue 73, 2005.

[9]Private operating foundations, subject to nearly all the private foundation rules but which offer public charity deductibility, are beyond the scope of this article. It is uncommon for a company-affiliated foundation to use this form.

[10]A fund meeting certain requirements described in Section 4966(d)(2)(B)(ii) can make grants to individuals.

[11]A fund meeting the requirements of Section 4966(d)(2)(B)(ii) could be set up to disburse grants to individuals.