

Corporate Philanthropy and Law in the United States: A Practical Guide to Tax Choices and an Introduction to Compliance with Anti-Terrorism Laws

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The modern legal empowerment of corporate philanthropy in the United States, the increased complexity of tax law, globalization, and the increased duties of due diligence required of grantmakers by actions taken by the President, the executive branch, and Congress in response to the terrorist attacks of September 11, 2001—together, these factors place increased demands on management in designing and administering an effective corporate philanthropy program. This article offers guidance on the basic tax choices available to today's manager of a corporate giving program in the United States, and it introduces a new requirement—compliance with anti-terrorism laws. But first, a brief review of the development of the two areas of law central to corporate philanthropy in America: corporation law and federal income tax law.

Legal Context

Public policy in America has not always favored corporate philanthropy. Corporate law and federal tax law have developed along separate but remarkably similar evolutionary paths, leading to an acceptance of corporate philanthropy. Yet fundamental questions about the legal rationale and structure of corporate philanthropy continue to intrigue and concern prominent legal scholars.^[1]

During the early stage of the development of modern corporate law, state courts interpreted the law to require corporations to pursue profit maximization.^[2] Corporate grantmaking was justified only to the extent that it could contribute to the bottom line. But other views soon emerged, aiming for broader managerial discretion by urging that the interests of other constituencies be balanced against the interest of shareholders or claiming that no conflict exists between a corporation's long-term interests and those of the community.^[3] The last major legal challenge to corporate philanthropy from a state law perspective was made in 1953 in *A. P. Smith v. Barlow*,^[4] in which a group of shareholders challenged the legality of corporate grantmaking. They sought a declaratory judgment that the company's board of directors acted beyond its powers in authorizing a donation of \$1,500 to Princeton University. In a celebrated opinion, the Supreme Court of New Jersey ruled against the shareholders. It upheld New Jersey statutory law that expressly permitted corporate contributions, and added that "corporate power to make reasonable charitable contributions exists under modern conditions, even apart from express statutory provision." The Court observed further that "free and vigorous non-governmental institutions ... are vital to our democracy and ... withdrawal of corporate authority to make ... contributions within reasonable limits would seriously threaten their continuance."

At the federal tax level, the development of laws providing a tax incentive for corporate philanthropy followed a similar course, with a slow movement from opposition to encouragement and support of corporate philanthropy.^[5] In 1918, Congress expressly refused to extend the charitable contribution deduction from individuals to corporations.^[6] Deductions by corporations for payments to charity were allowed only if they "represented consideration for a benefit flowing directly to the corporation."^[7] But that pattern was broken as the result of the 1934 U.S. Supreme Court decision in *Old Mission Portland Cement Co. v. Helvering*.^[8] The Court upheld the denial of federal income tax deductions for corporate contributions of \$1,000 per year over a four-year period to the San Francisco Community Chest. The Court pointed out that Congress had not extended the charitable contribution deduction to corporations. Although the expenditure "resulted in good will" toward the corporation, there was no evidence, said the Court, "of any direct benefit" to its business. In response to a lobbying campaign led by community chests, Congress quickly responded by amending federal income tax laws to include, for the first time, a provision expressly permitting corporations to deduct charitable contributions. New Deal concerns about the growing economic power of large corporations prompted strong opposition from President Franklin Roosevelt and many Democratic members of Congress,^[9] but the amendment was ultimately adopted.^[10]

Tax Choices

Corporate philanthropy has become a permanent feature of the legal landscape in the United States. To manage a corporate giving program successfully requires a working knowledge of the underlying tax issues. In this article, we explore the four major tax choices available for domestic and international corporate giving—(1) direct corporate giving, (2) company foundation grants, (3) donor-advised fund grants, and (4) promotional or marketing expenses—and we consider major non-tax legal restrictions on charitable giving. Each choice carries benefits as well as limitations. Our goal is to provide a corporate giving manager with preliminary guidance in sorting through these options so as to make at least a tentative determination as to which choices best serve the interests of the company in most domestic or international giving situations.[\[11\]](#)

Direct Corporate Giving: Domestic

Corporate law does not restrict the ability of a corporation to make gifts that promote corporate goals, even if there is no direct and immediate economic benefit to the corporation, as we learned from *A.P. Smith v. Barlow*. Federal tax law imposes limitations, however, if the corporation seeks a charitable deduction. Like other taxpayers, a corporation may obtain a charitable deduction only if it gives to a qualified donee, such as a qualified charitable organization or a governmental unit for public purposes.[\[12\]](#) Thus, corporations may not deduct contributions made directly to individuals, however compelling the cause. This restriction may be determinative in causing the corporation to make a particular grant through the company foundation rather than through the company's giving program. In addition, percentage limitations apply to corporate charitable deductions: a corporation may not deduct charitable contributions in excess of 10 percent of the corporation's taxable income.[\[13\]](#)

Example 1. *Corporation A has offices in New York and San Francisco. It makes grants through its corporate giving program and also through the A Foundation, which Corporation A funds and controls. Corporation A has long been known as a major funder of the arts. Its board is considering a five-year model program of grants and awards directly to deserving artists on both coasts in the total annual amount of \$500,000. What tax choices are preferred? What tax choice should be avoided?*

Comment. Funding the program directly through the corporation's giving program should probably be avoided, since it will deprive the corporation of the flexibility to fund individual artists directly. The program may legitimately be funded by A Foundation, however, once it has obtained Internal Revenue Service (IRS) approval of its grantee selection and monitoring procedures.[\[14\]](#) Alternatively, the donor-advised fund model[\[15\]](#) may be particularly useful if A Foundation intends to attract other foundation and corporate support for the grants and awards program for artists.

Direct giving by a corporation may include property as well as money. Corporations may claim a charitable contribution deduction for gifts of inventory. Ordinarily, the amount of the deduction is limited to the cost of the inventory items rather than their fair market value.[\[16\]](#) For computers and other qualified inventory items meeting certain requirements, a larger deduction may be taken, equal to the lesser of (a) twice the cost and (b) half the difference between cost and market.[\[17\]](#) Thus, if the manufacturer donates a qualified computer that costs \$500 and sells for \$3,000 to a Section 501(c)(3) organization, the charitable deduction is the lesser of \$1,000 and \$1,250.[\[18\]](#)

Direct Corporate Giving: International

Two rules limit foreign charitable contributions by a domestic corporation. Like any U.S. taxpayer, a domestic corporation may deduct charitable contributions only if made to a charitable organization "created and organized in the United States."[\[19\]](#) But unlike any other U.S. taxpayer, a domestic corporation may take a charitable deduction for a contribution that will be used outside of the United States only if the U.S. charitable donee is a corporation.[\[20\]](#)

Example 2. *Corporation B, located in Santa Fe, New Mexico, funds performing arts organizations, including the Santa Fe Opera. The director of the Opera seeks funding from Corporation B for its*

foreign tour and for bringing a Stuttgart Opera production to San Francisco. May Corporation B fund those activities directly?

Comment. Since the Santa Fe Opera is “created and organized in the U.S.,” Corporation B may fund it directly, deducting the contribution under Section 170.[\[21\]](#) This is so even though the activities funded will occur entirely outside the United States. Indeed, the deduction would be allowed for the contribution even if the sole activity of the U.S. charity occurred outside the United States.[\[22\]](#) To deduct the contribution related to the Stuttgart Opera production, Corporation B must be careful to make its contribution to the domestic charity, the Santa Fe Opera, and subject to its discretion and control, rather than directly to the Stuttgart Opera.

Multinational U.S. corporations with foreign source income must also take into account the interplay of the foreign tax credit and the charitable contribution deduction. A higher foreign tax credit results in a lower U.S. tax liability. In computing the foreign tax credit limitation, a taxpayer must determine its U.S. source income and its foreign source income, and it must allocate U.S. income tax deductions in accordance with the gross income from those two sources. The current regulations require proportionate allocation of charitable contribution deductions between U.S. and foreign source income. To the extent that the deduction is allocated against foreign source income, it will reduce the available foreign tax credit.[\[23\]](#) However, foreign grants by company foundations of multinational U.S. corporations do not reduce available foreign tax credits. Consequently, where foreign tax credits are at stake, grants by company foundations rather than direct contributions by the corporation may be the preferred choice.

Company Foundation Grants: Domestic

Most company foundations are classified as private foundations under federal tax law, because all the assets come from a single source: the corporate founder. Thus, company foundations are subject to all of the rules applicable to private foundations, including a minimum annual payout obligation of 5 percent of the net fair market value of the foundation’s assets; an annual excise tax of 1 to 2 percent of the net investment income of the foundation; and an obligation to avoid imprudent investments, excess holdings of interests in business, and specified improper expenditures.[\[24\]](#) Because of the close relationship between a company and a company foundation, the private foundation obligation that is often most troublesome to company foundations is the duty to avoid self-dealing.

Federal tax law forbids private foundations from engaging in transactions that confer an economic benefit on a disqualified person. For a company foundation, the disqualified person category includes its directors, key employees, and family members as well as the corporation and the company’s officials and other agents if, as is generally the case, the company is a substantial contributor.[\[25\]](#) In this section, we briefly discuss areas of particular self-dealing risk to company foundations where the IRS has provided guidance.

Pledges. Self-dealing includes the use of company foundation assets to pay the charitable pledge of the corporation, the corporation’s CEO, or any other disqualified person to the foundation.[\[26\]](#) Financial penalties are not the only possible adverse consequence of a private foundation’s payment of a charitable pledge made by a disqualified person. In some circumstances, payment of the pledge may be treated as a disguised or constructive dividend to the pledgor who is also a shareholder of the corporation.[\[27\]](#)

Shared Expenses. Under what circumstances may a foundation and a related company share facilities, equipment, goods, and services? A quick guide is appended containing various examples of shared foundation operating expenses. “Follow the money” is as helpful a guide to solving self-dealing problems as it is to solving more popular mysteries. If economic benefit (the money) flows from the company to the foundation, self-dealing is probably not an issue, but if it flows the other way, from the foundation to the company or related disqualified persons, self-dealing may be involved. Thus, the company may pay for or provide office space, supplies, and equipment for the foundation. The foundation may pay these expenses itself if the payee is an unrelated provider. A similar pattern applies to most other foundation operating expenses. Only a few expenses, such as salaries and

professional fees,[\[28\]](#) lend themselves to an allocation or reimbursement arrangement between the foundation and the company, based on detailed record-keeping. Advice from legal counsel familiar with the self-dealing rules is advisable in structuring such an arrangement.

Tickets. Company foundations, particularly those that fund performing arts organizations, frequently purchase or receive complimentary tickets from prospective grantees. The foundation must take great care in handling such tickets to avoid self-dealing. The IRS has ruled that bifurcation is not a solution.[\[29\]](#) That is, the foundation may not avoid self-dealing by requiring the CEO or the company to pay the cost or fair market value of the meal and entertainment with the foundation paying the charitable contribution portion of the ticket. The CEO still receives an improper benefit from the expenditure of foundation funds.

Example 3. *Foundation C purchased tickets to 39 fundraising activities conducted by various charities that it normally supports. Most of the tickets were used without charge by the directors, officers, and employees of Foundation C, but tickets to 17 of the events were given to the CEO of Corporation C and guests—even though the CEO was not an officer, director, or employee of Foundation C. Did the use of tickets by the CEO and his guests constitute self-dealing? What about the use of the tickets by the directors, officers, and employees of Foundation C?*

Comment. The material facts in our example are taken from an IRS ruling that determined that expenditures allocable to the benefits received by the CEO and his guests constituted self-dealing. Foundation C failed to show that any portion of those expenses were reasonable administrative expenses. The CEO was acting as an agent of Corporation C, not Foundation C. However, the IRS ruled that the tickets provided to the directors, officers, and employees of Foundation C were reasonable and necessary expenses related to the performance of their foundation duties and did not constitute self-dealing.[\[30\]](#)

Thus, a company foundation must avoid transactions where the company or its directors, officers, or employees, who have no relationship to the foundation, may receive tangible economic benefits as a consequence of a foundation expenditure. For this reason, managers of corporate philanthropy programs often prefer to use company funds, deductible either as charitable contributions or as business expenses, to purchase tickets to charitable fundraising events, rather than company foundation funds.

Incidental and tenuous benefit. Not all benefits are prohibited. IRS regulations provide that an exception to self-dealing exists for an *incidental or tenuous* benefit received by a disqualified person from the use of foundation income or assets.[\[31\]](#) The IRS has ruled that:

[A]n incidental and tenuous benefit occurs when the general reputation or prestige of a disqualified person is enhanced by public acknowledgement of some specific donation by such person, when a disqualified person receives some other relatively minor benefit of an indirect nature, or when such a person merely participates to a wholly incidental degree in the fruits of some charitable program that is of broad public interest to the community.[\[32\]](#)

The IRS regards public recognition and good will as being without economic value for purposes of donor benefit analysis.

Example 4. *Foundation D awards scholarships to high school students. The foundation insists that all publicity concerning the scholarships credit Corporation D as well as Foundation D. Has the foundation engaged in self-dealing?*

Comment. No, the Foundation has not engaged in self-dealing. This is a classic example of the sort of public recognition to a disqualified person (Corporation D) that constitutes a permissible “incidental and tenuous benefit” rather than self-dealing.[\[33\]](#) Thus a company may receive recognition, including the display of the company name and logo, from the philanthropic efforts of the related company foundation without causing the foundation to violate the self-dealing rules.[\[34\]](#)

Disaster relief. In a major post-September 11, 2001, pronouncement, the IRS stated that “providing aid to relieve human suffering that may be caused by natural or civil disaster or an emergency hardship is charity in its most basic form.”[\[35\]](#) The IRS has not always been able to locate firm ground from which to provide guidance, particularly where company foundations seek to provide disaster relief to company employees.[\[36\]](#)

The enactment of the Victims of Terrorism Tax Relief Act, which added IRC § 139 to the Internal Revenue Code, has eliminated some confusion. It provides that gross income does not include any amount received by an individual as a disaster relief payment. Section 139 defines qualified disasters to include acts of terror, a disaster resulting from an airplane, train, or other common carrier accident, and any other disaster declared by the appropriate local, state, or federal authorities.[\[37\]](#) Section 139 also defines a qualified disaster relief payment.

For company foundations wanting to make disaster relief payment to employees, the legislative history of the act sets forth the ground rules.[\[38\]](#) The IRS will *presume* that qualified disaster payments made by a private foundation to employees (or their family members) are charitable, are not self-dealing, and do not constitute income to the recipient if: (1) the class of beneficiaries is large or indefinite, (2) the recipients selected are based on an objective determination of need, and (3) the selection is made using either an independent selection committee or other procedures designed to ensure that any benefit to the employer is incidental and tenuous. The presumption does not apply if the payments are made to disqualified persons.[\[39\]](#)

Example 5. *Corporation E is located in an area affected by a severe flood that was declared a disaster by the President. Corporation E made grants available to all of its employees who were adversely affected by the flood. The grants were intended to reimburse employees for medical, temporary housing, and transportation costs, but not to reimburse the cost of luxury or decorative items or services. The employees were not required to provide proof of actual expenses. The program contained procedures to assure that the grant amounts were reasonably commensurate with the amount of allowable reimbursable expenses.*

Comment. The IRS ruled that payments to the employees, under similar facts, are excludable from their gross income under IRC § 139.[\[40\]](#) It is unlikely that the payments could be deducted by Corporation E under IRC § 170 because the beneficiary class consists of all employees and is not indefinite, a fundamental charitable requirement. However, the ruling also states that the payments were not gifts and were made to compensate employees. Accordingly, the payments should qualify as deductible business expenses under IRC § 162.

Company Foundation Grants: International

Grants by a company foundation to a U.S. charity that makes grants abroad or conducts direct operations outside of the United States are subject to the same federal tax rules as grants made by that private foundation to any other U.S. charity.[\[41\]](#) Most such charitable organizations are classified as public charities by the IRS, making grant administration a straightforward and relatively simple matter.

If a company foundation prefers instead to make grants directly to a non-U.S. charity, two methods are available: expenditure responsibility grants and equivalency determinations.[\[42\]](#)

Expenditure responsibility. IRS regulations require private foundations to follow expenditure responsibility procedures in making grants to any grantee that is not a public charity.[\[43\]](#) The procedures consist of four steps: (1) a pre-grant inquiry, (2) a written grant agreement, (3) reports from the grantee on the status of the grant, and (4) disclosure of such grants to the IRS on Form 990-PF. If the grantee is not the equivalent of a U.S. private foundation, then the grantee must, in addition, maintain the grant in a separate fund restricted to a charitable purpose. The expenditure responsibility route allows for considerable flexibility. Edie and Nober comment that if the foundation “is willing to follow the required procedures, it may make a grant for charitable purposes to virtually any kind of organization almost anywhere in the world.”[\[44\]](#)

Equivalency determination. If the company foundation is able to determine that the non-U.S. grantee is the equivalent of a U.S. public charity, then the foundation may make the grant without exercising expenditure responsibility. Unfortunately, the documentation required to make that determination is extensive; it is virtually the same information the grantee would be required to provide to the IRS to obtain a tax exemption. Traditionally, the actual equivalency determination was made by legal counsel for the private foundation in a written legal opinion, which protects the foundation and its directors. Since 1992, however, IRS has permitted a private foundation to make its determination based on a written affidavit of the grantee, without the need of a written legal opinion.[\[45\]](#)

Which option is preferable? Few company foundations are likely to evaluate the strengths and weaknesses of each option in the same manner. Some foundations may find the expenditure responsibility rules daunting, while other foundations, whose normal grantmaking procedures include a pre-grant inquiry, a written grant agreement, and grantee reports, may find the expenditure responsibility procedures quite familiar and not at all burdensome. Whether equivalency determination is arduous or workable will often depend on whether the non-U.S. charity has the desire and the expertise to generate the many required documents and to translate them into acceptable English. The burden of an equivalency determination is likely to be experienced differently by the foundation whose staff makes its own determination than by the foundation that turns the entire determination over to legal counsel.

Foreign tax credit. Earlier, we considered the reduction in the foreign tax credit due to the requirement of allocating charitable contribution deductions to foreign source income.[\[46\]](#) No such requirement applies, of course, if the charitable expenditure is made in the form of a grant from a company foundation rather than as a direct corporate contribution.[\[47\]](#) For this reason, multinational U.S. corporations often prefer to make charitable expenditures from endowed company foundations or donor-advised funds rather than directly from the company.

Example 6. *Corporation F, a music production company, is a U.S. corporation with offices in United States and Ireland. F's directors are young and idealistic, and they regard themselves as activists promoting positive social change. In particular, they believe that F's goals are furthered by encouraging the development of civil society internationally. Accordingly, the directors of Corporation F want to expand F's domestic matched giving program to F's employees in Ireland.*

Comment. Since the organizational beneficiaries of gifts by F's employees in Ireland will presumably be Irish charities rather than U.S. charities, F may not fund the match directly because F may only deduct contributions made to a U.S. charity. Even if the gifts are matched by F's company foundation, some procedure must be devised to assure that the funds are spent by the Irish grantees for charitable purposes. One option, growing in popularity, is to enter into an agreement with a qualified U.S. international charitable facilitator, knowledgeable about local charities in a particular region abroad. The agreement would require the facilitator to review the gifts by the employees to determine whether the Irish donees satisfied specified charitable criteria. The agreement would also provide that Corporation F or its company foundation would make contributions to the facilitator to fund the qualified employee gifts.

Donor-Advised Funds: Domestic

The rapid and widespread growth of donor-advised funds is a major development in modern philanthropy.[\[48\]](#) The benefits of donor-advised funds are well advertised.[\[49\]](#) Properly used, a donor-advised fund can enhance a company's corporate philanthropy program.[\[50\]](#)

Donor-Advised Funds: International

International grants need not be more complex than domestic grants. In fact, a significant number of international grants are now made by means of grants from corporations and other taxpayers to donor-advised funds that specialize in facilitating grants abroad. We refer to donor-advised funds that have developed the resources and expertise to facilitate and oversee the proper use of grant funds abroad as U.S. international charitable facilitators. The list of qualified international charitable

facilitators has been growing. It has recently become possible for a U.S. individual, corporation, or charitable organization to make contributions or grants by such means to fund public benefit activities occurring in most regions of the world. [\[51\]](#)

Example 7. *Corporation G, with headquarters in New York, is a multinational corporation that designs, manufactures, and sells casual clothing throughout the world. G has been actively involved in international philanthropy for over 50 years. Some years ago, the board decided to operate its international grantmaking program entirely through its endowed foundation rather than through the corporation.*

Comment. G Foundation makes some foreign grants by exercising expenditure responsibility, and it makes others through U.S. international charitable facilitators. But most of its grants abroad are made, using equivalency determinations, to donor-advised fund arrangements within two nonprofit organizations: a major foundation in France through which G supports European charities, and a highly regarded charity in Japan through which G supports charities in Asia. G Foundation has qualified those non-U.S. organizations as foreign public charity equivalents under U.S. law to enable them to facilitate equivalency determination grants from other U.S. foundations as well as from G Foundation.

Promotional Expenditures: Domestic

Corporate contributions may qualify as deductible business expenses under IRC §162 as well as deductible charitable contributions under IRC §170. These deduction categories often overlap. Only rarely will the choice be dictated by tax law. But the corporate manager should be aware that Section 162(b) bars a deduction under Section 162 if the expenditure would qualify under Section 170 but for percentage and other specified limitations. Usually, however, the company will be free to follow budgetary or other managerial policies in making that choice.

Example 8. *For many years, Corporation H had made a practice of contributing \$10,000 to the local PBS station during its annual year-end fundraising effort. Corporation H receives on-air recognition and is listed as a donor on the PBS website. Is that contribution deductible as a charitable contribution under Section 170 or as a business expense under Section 162?*

Comment. Since the PBS station is incorporated in the U.S. and is exempt under IRC § 501(c)(3), Corporation H's contribution will qualify for a deduction under Section 170 if this deduction, together with all other charitable deductions in the current year, does not exceed 10 percent of the taxable income of H. Since H receives a business benefit from its contribution due to favorable publicity, it may, alternatively, deduct the contribution as a business expense under Section 162.

Promotional Expenses: International

Similarly, a corporation will often have the option of deducting its international expenditure as a business expense under IRC § 162 rather than as a charitable contribution, although management should carefully scrutinize the adequacy of the benefit expected by the corporation from the expenditure, to make sure the deduction passes muster under Section 162.

Example 9. *Corporation M is a developer and manufacturer of computers and software. It also has an affiliated company foundation. Its co-founders and sole shareholders were born in Taiwan, in the same small village on the other side of the island from Taipei. M also has an assembly plant near Taipei. The founders want to give back to their village by contributing \$1.5 million to restore a local temple that has fallen into disrepair and to build a community center. What tax pitfalls should M's corporate giving manager be aware of? What tax choice is best?*

Comment. In the absence of any facts about post-contribution recognition to Corporation M, the business benefit to M may not be direct enough to qualify the payment, without risk, as a deductible business expense under IRC § 162. We know that M may not make a direct grant to a Taiwanese charity to achieve the founder's charitable goals because the charity is not a U.S. corporation. M could

make the grant through its company foundation, but the foundation lacks the resources to administer and oversee the construction project. Corporation M identified an international charitable facilitator with recognized on-the-ground oversight capacity in Taiwan. With legal counsel's assistance, Corporation M established a donor-advised fund relationship with the charitable facilitator that had administered economic development and community restoration projects in East Asia. The facilitator agreed to take on the village project by selecting a local general contractor and by monitoring the repair of the temple and the design and construction of the community center, subject to the advice of Corporation M.

Non-Tax Legal Restrictions on Charitable Giving

Any analysis of tax choices in corporate philanthropy would be incomplete without consideration of other laws that may limit or restrict those tax options. Four statutory provisions are relevant: (1) the Export Administration Act^[52] ("EEA"), (2) the Trading with the Enemy Act^[53] ("TWEA"), (3) the International Emergency Economic Powers Act^[54] ("IEEPA"), and (4) the USA Patriot Act^[55] ("USAPA").

Each act contains distinctive provisions. The EEA, regulating exports generally, is least restrictive. It does not limit monetary contributions, and its limitations on donations of goods contain an important humanitarian exception allowing most donations of goods that meet basic human needs. The TWEA regulates or prohibits donations of money and goods to listed nations, currently Cambodia, Cuba, and North Korea. Under the IEEPA, contributions of money may be regulated or prohibited whenever a national emergency has been declared, but donations of goods require an additional presidential determination. Determinations under IEEPA are currently in effect for Angola, Haiti, Iran, Iraq, and Libya, though most restrictions against Libya were lifted in April 2004. {OK?}

The broadest prohibitions under IEEPA are contained in Executive Order 13224,^[56] promulgated shortly after the terrorist attacks of September 11, 2001. It prohibits the donation of money or humanitarian articles, such as food, clothing, and medicine, to specified donees. For the first time, the proscribed donees are individuals, organizations, and other "listed persons," rather than nation-states.

Within a month after the Executive Order, Congress passed USAPA, which adds a list of specially designated nationals and blocked persons, expands jurisdiction over the crime of providing support for terrorism, and allows for civil penalties or imprisonment of up to 15 years for any person who provides material support and resources knowing or intending that they are to be used in terrorist acts by listed foreign terrorist organizations.

In response to concern in Arab American and American Muslim communities about the chilling effect of the Executive Order and USAPA on legitimate charitable contributions to organizations, the government issued a document entitled *U.S. Department of the Treasury Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S.-Based Charities*.^[57] Unfortunately, those guidelines call for due diligence procedures that are so demanding that full compliance may not be possible. For example, some of the guidelines appear to require information about the grantee that may be beyond the capacity of any grantor to obtain in some countries and may not be available at all in others. So long as they remain an expression of Treasury policy, however, a good-faith attempt to comply with the guidelines and with USAPA may reduce the chance of blockage of assets and any other official action against a grantor. Another choice may carry less risk—and it may be the only option (short of making no foreign grants) for a grantor that lacks the resources to make even a plausible good-faith effort. That option is to make grants in sensitive areas only through a qualified intermediary such as a respected international charitable facilitator, which can exercise, to the maximum extent possible, the level of due diligence described in the guidelines, as well as check the grantee against the list in Executive Order 13224 and added by the Patriot Act.^[58]

Managers of corporate philanthropy programs would be well-advised to remain alert for changes in laws, regulations, and enforcement practices that may modify existing Treasury guidelines or require an additional level of due diligence and compliance in grantmaking. On May 5, 2003, for example, the IRS published a formal request for public comment on "how it might clarify existing requirements that

section 501(c)(3) organizations must meet with respect to international grantmaking and other international activities.” In its request the IRS mentioned improper diversion of charitable assets but also acknowledged the important role of international philanthropy. A likely outcome of the comment process will be the promulgation of rulings or other documents providing additional guidance under existing law. It is also conceivable that Treasury may submit additional legislation. But it is a certainty that the international grantmaking process will become, as a result, more rule-bound.

Table 1

Quick Guide to the Self-Dealing Rules for

Foundation-Related Operating Expenses

Item of Expense	When Permitted	When Prohibited
Reasonable salaries and benefits for personal services performed for Foundation.	<ol style="list-style-type: none"> 1. Paid by Company and not reimbursed by Foundation. 2. Paid by Company and reimbursed by Foundation, for time that is documented by reasonable time sheets. 3. Paid directly by Foundation to employee. 	<ol style="list-style-type: none"> 1. Foundation can't pay where employee who works for both Company and Foundation, is a disqualified person, and fails to keep reasonable time sheets. 2. Payment can't take the form of a loan from Company to Foundation employee, even if secured, and even if at market rate.
Legal and accounting fees of Foundation	<ol style="list-style-type: none"> 1. Paid by Company and not reimbursed by Foundation. 2. Paid by Company and reimbursed by Foundation, for work that is for Foundation, as reflected on the professional bills. 3. Paid directly by Foundation to third-party provider. 	Where Foundation pays Company and it is not clear that the professional work is for the Foundation.
Travel (such as airfare, hotels, meals, and taxis) for Foundation	<ol style="list-style-type: none"> 1. Paid by Company and not reimbursed by Foundation. 2. Paid by Company and reimbursed by Foundation, but only where the expense is clearly identifiable as a Foundation expense. 3. Paid directly by Foundation to employee. 	Recommend against reimbursing Company for travel with a joint Company-Foundation purpose. Extremely difficult to manage in a legal way.
Office space, office equipment purchase or rental, office supplies, and telephone for Foundation.	<ol style="list-style-type: none"> 1. Paid by Company and not reimbursed by Foundation. 2. Paid directly by Foundation to an unrelated third-party provider. 	Foundation can't pay or reimburse Company.

Table 2**Quick Guide to International Contributions by Corporations**[\[59\]](#)

Grantee	Can You Fund?	Is grant deductible?	Comments
1. U.S. 501(c)(3) charity operating outside U.S.	Yes	Yes	Note that the donee must be a corporation. Otherwise, the rules are the same for other grants.
2. Corporate or other private foundation that funds non-U.S. institutions	Yes	Yes	Same as above. Must avoid earmarking grant.
3. "Friends of" organization	Yes	Yes	Same as 2.
4. Donor-advised fund of U.S. charity	Yes	Yes	Same as 2.
5. Non-U.S. charity with 501(c)(3) status	Yes	No	No charitable deduction but may qualify for business expense deduction.
6. Non-U.S. 501(c)(3) equivalent	Yes	No	Same as 5.
7. Other non-U.S. organizations	Yes	No	Same as 5.
8. To individual donee for charitable project in or out of U.S.	Yes	No	Same as 5.

Table 3**Quick Guide to International Grants by Company Foundations**[\[60\]](#)

Grantee	Can You Fund?	Does grant count toward minimum distribution requirement?	Comments
1. U.S. 501(c)(3) classified as a public charity and operating outside the U.S.	Yes	Yes	This grant is treated no differently than any other grant to a U.S. public charity.
2. U.S. corporate or other private foundation that funds non-U.S. institutions.	Yes	Yes	Grants to U.S. charitable grantees other than public charities require the exercise of corporate responsibility.
3. "Friends of" organizations	Yes	Yes	Same as 1.
4. Donor-advised fund of U.S. charity	Yes	Yes	Same as 1, but must avoid earmarking grant.
5. Non-U.S. charity equivalent to a 501(c)(3)	Yes	Yes	Either equivalency grant or expenditure responsibility grant is permissible.

6. Non-U.S. charity not equivalent to a 501(c)(3)	Yes	Yes	Restrict grant to charitable project. Expenditure responsibility grant only.
7. Other non-U.S. organizations for charitable project	Yes	Yes	Same as 6.
8. To individual grantee for charitable project in or out of U.S.	Yes	Yes	Same as 6.

Table 4

Comparing the Tax Choices

for Corporate Philanthropy

Tax Choices				
	Direct Giving (deductible under IRC § 170)	Company Foundation	Donor-Advised Fund	Promotional Expense (deductible under IRC § 162)
Company can control	Yes	Yes	No, but most donor advice is followed	Yes
Ease of administration	Yes	No	Yes	Yes
Grants to individuals allowed	No	Yes	Varies among donor-advised fund charities	Yes, but grantee may be taxed
Avoid self-dealing penalties	Yes	No	Yes	Yes
Grants to foreign orgs. allowed	No	Yes	Varies among donor-advised fund charities	Yes
Avoid withholding on targeted grants to foreign persons	Not applicable	Yes	Yes	No
Least impact on foreign tax credit	No	Yes	Varies among donor-advised fund charities	No

Notes

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[1] See, e.g., Evelyn Brody, *Charities in Tax Reform: Threats to Subsidies Overt and Covert*, 66 *Tenn. L. Rev.* 687 (1998); Jerome L. Himmelstein, *Looking Good and Doing Good: Corporate Philanthropy and Corporate Power* (Indiana, 1997). In a recent law review article, Harvard professors Victor Brudney and Allen Ferrell ask a provocative question: Who in the corporate structure is (or should be) empowered to authorize corporate charitable expenditures—management or stockholders? Brudney and Ferrell, *Corporate Charitable Giving*, 69 *U. Chicago L. Rev.* 1191, at 1192 and 1208 (2002). They opt for the stockholders, arguing that laws should be enacted to compel corporations to turn to their stockholders for the selection of charitable donees of the corporation. The authors also consider the mechanism of imposing such a rule by a statute applicable to all public investor-owned corporations, but they prefer the approach of amending IRC § 170 of the Internal Revenue Code so that corporations may deduct charitable contributions only if the donees are selected by the stockholders individually. *Id.* at 19.

[2] See *Dodge v. Ford Motor Co.*, 170 N. W. 668, 684 (Mich. 1919). In a case decided at the dawn of the Automotive Age, the court compelled Ford to declare dividends to benefit its shareholders, rejecting Henry Ford's argument that because customers were stakeholders too, profits should also be shared with them by reducing the price of the cars.

[3] For a brief but excellent introduction to these concepts see Choper, Coffee, and Morris, *Cases and Materials on Corporations* at 36-37 (3d ed. 1989).

[4] 98 A.2d 581 (N. J. 1953), appeal dismissed, 346 U.S. 861 (1953).

[5] See Chang, Goldberg, and Schrag, *Cross Border Charitable Giving*, 31 *U.S.F. Law Rev.* 563 at 580-586.

[6] Cong. Rec. 10,426 (1918).

[7] See e.g., *Treas. Reg.* § 65, art. 562 (1926).

[8] 293 U.S. 289, 293 (1934).

[9] See 79 Cong. Rec. 12,423 (1935).

[10] Revenue Act of 1935, Pub. L. No. 74-407 § 102(c), 49 Stat. 1014, 1016.

[11] The publications program of the Council on Foundations (www.cof.org) has become sufficiently comprehensive to provide a solid understanding of the concepts and details of charitable law and federal income tax law applicable to domestic and international corporate philanthropy. See e.g., John A. Edie, *Expenditure Responsibility: Step by Step* (2002); John A. Edie and Jane C. Nober, *Beyond Our Borders: A Guide to Making Grants Outside the United States* (2nd ed., 1999); Jane C. Nober, *Company Foundations and the Self-Dealing Rules* (2002); and Betsy Buchalter Adler, *The Rules of the Road: A Guide to the Law of Charities in the United States* (1999).

[12] IRC § 170 (c).

[13] IRC § 170(b)(2). Corporate charitable contributions in excess of that limit may be carried forward and deducted over the next five years, subject to the same annual percentage limitation. IRC § 170(d)(2).

[14] IRC § 4945(g)(3). See the discussion of company foundations, below.

[15] See the text accompanying notes 48-49.

[16] IRC §170(e)(1)(A)

[\[17\]](#) IRC §170(e)(3)-(6).

[\[18\]](#) Ordinarily, however, a corporation that donates inventory property will not take any deduction under IRC § 170; the deduction will instead come in the ordinary course of business as though the donated item had been sold.

[\[19\]](#) IRC § 170(c)(2)(A). This statutory limitation may be superseded by treaties. For example, U.S. tax treaties with Canada, Mexico, and Israel allow U.S. taxpayers to deduct contributions to charities within those countries, but only to the extent of income derived in those countries. Thus, only U.S. corporations with a branch or a subsidiary in a treaty country are likely to be able to deduct contributions made to charities within that country.

[\[20\]](#) IRC § 170 (c)(2). See Table 2, Quick Guide to International Grants by Corporations, attached.

[\[21\]](#) In addition, Corporation B's total charitable deductions for the tax year may not exceed 10 percent of B's taxable income. IRC Section 170(b)(2).

[\[22\]](#) Bilingual Montessori School of Paris, Inc. v. Commissioner, 75 T.C. 480.

[\[23\]](#) Id., Cross Border Charitable Giving, note 6 at p. 587-590. The IRS proposed regulations in 1991 that would alter that allocation rule. The charitable deduction would be allocated entirely to foreign source income if the taxpayer knows or has reason to know that the contribution will be used solely outside of the United States, thus reducing the foreign tax credit and the benefit of the charitable deduction. The proposed regulation provoked strong opposition from international charities, and it has never become final. Yet it has never been withdrawn. We have been advised, informally, that current IRS policy permits taxpayers to rely on either the current or proposed regulations, as they choose.

[\[24\]](#) Id. The Rules of the Road, note 11, at 29-39, for a brief summary of the private foundation rules.

[\[25\]](#) The extension by the IRS of the definition of disqualified person to cover corporate agents even if they are not major stockholders of the company or foundation managers of the company foundation has occurred without fanfare, in the form of unpublished rulings (see TAM 8449008 and PLR 9021066), and without challenge.

[\[26\]](#) See, e.g. Rev. Rul. 77-160, 1977-1 C.B.385 (payment by a private foundation of the church dues of a disqualified person constitutes self-dealing). A weakening of the doctrine of consideration and the growth of a social policy favoring charities has resulted in the enforcement of charitable pledges as a matter of course without reference to legal doctrine. See, e.g. Melvin A. Eisenberg, The World of Contracts and the World of Gifts, 85 Calif. L. Rev. 821, 824 (1997); Mary Francis Budig et. al., Pledges to Nonprofit Organizations: Are They Enforceable and Must They Be Enforced? 27 U.S.F. Law Rev. 47, 51 (1992).

[\[27\]](#) See e.g., Shephard v. Commissioner, 340 F.2d 27 (6th Cir, 1964) (cancellation of a debt confers a taxable economic benefit on the debtor).

[\[28\]](#) For an extensive discussion of shared expenses, including the citation of authorities, see Company Foundations and the Self-Dealing Rules, note 11, at 18-26.

[\[29\]](#) PLR 9021066.

[\[30\]](#) PLR 8449008.

- [31]** Reg. § 53.4941(d)(2)(f)(2).
- [32]** Rev. Rul. 77-331, 1977-2 C.B. 388.
- [33]** These basic facts are contained in an IRS private letter ruling. PLR 9431029.
- [34]** See e.g. Rev. Rul. 73-407, 1973-2 C.B. 383 (the IRS found an “incidental and tenuous benefit” rather than self-dealing where foundation promised to give charity a large sum of money if charity changed its name to that of a substantial contributor to the foundation and agreed to refrain from changing its name again for one hundred years).
- [35]** IRS Publication 3833, Disaster Relief: Providing Assistance through Charitable Organizations. Available at www.irs.gov/eo.
- [36]** Compare PLR 95116047 and PLR 9544023 (permitting disaster relief payments by company foundations to employees who suffered hardship as a result of major disasters where payments did not benefit disqualified persons) with PLR 199914040 and PLR 199917077 (revoking the former rulings because the programs may attract new employees and existing employees will consider the program an incentive to continue their employment).
- [37]** Because IRC § 139 refers to authorities of the U.S. government, company foundations may be limited in aiding company employees outside of the United States except in connection with acts of terror or common carrier disasters.
- [38]** Joint Committee on Taxation, Technical Explanation of the “Victims of Terrorism Relief Act of 2001,” as passed by the House and Senate on December 20, 2001. Guidance may also be found in IRS Publication 3833 (see footnote 33, above) and in Gitterman and Friedlander, Disaster Relief—Current Developments, which appears in the Exempt Organizations-Technical Instruction Program for FY 2003, available at www.irs.gov/eo. See also Adler and Rosen, Disaster! Practices and procedures for charities providing relief after 9/11: A case study, 96 Journal of Taxation 297 (May 2002).
- [39]** Even if the presumption is not applicable, a company foundation may not be out of luck, for the IRS notes that a foundation “may still be operating consistent with the rules for charities when all facts and circumstances are taken into account.” IRS Publication 3833, note 33, at p. 17.
- [40]** Rev. Rul. 2003-12, 2003-3 I.R.B. 283.
- [41]** Rev. Rul. 66-79, 1966-1 C.B. 48. This key ruling has come to stand for the broad proposition that the role of a domestic charitable intermediary must have legal substance to receive tax recognition. Specifically, donors may deduct under IRC § 170 contributions they make to a domestic charitable organization soliciting for a particular foreign charity, but only if the foreign charity furthers the purposes of the domestic charity that has “discretion and control as to the use of the contributions received by it.”
- [42]** See Table 3, Quick Guide to International Grants by Company Foundations, attached.
- [43]** Treas. Reg. § 53.4945-5.
- [44]** Id.; Beyond Our Borders, note 11 at 29.
- [45]** Rev. Proc. 92-94, 1992-2 C.B. 507.
- [46]** See the text accompanying note 22.

[47] The proposed regulation referred to in note 22 would have changed that result by requiring that the charitable deduction for a contribution to the company foundation be allocated entirely to foreign income if the taxpayer knew that the contribution would be used by the foundation to make foreign charitable expenditures.

[48] A donor-advised fund ("DAF") is a fund created in a public charity by or for a corporation or other donor. All donations, together with complete legal control over the fund, pass from the donor to the donee, but the donor may offer advice to the donee with regard to charitable distributions from the fund, subject to terms and conditions mutually agreed upon. The IRS was unsuccessful in its initial attempt to persuade courts to outlaw donor-advised funds (National Foundation, Inc. v. United States, 87-2 U.S.T.C. ¶ 9602 (Ct. Cl. 1987)). The IRS has also failed in the most recent round of litigation (Fund for Anonymous Gifts v. United States, 99-1 U.S.T.C. ¶ 50,440 (D.C. Cir. 1999)). The IRS finally settled the case by conceding that the donor-advised fund involved is entitled to an advance ruling as a public charity. 98 Tax Notes, p. 1506 (Monday, March 10, 2003); telephone conversation on March 13, 2003, between the author and Amber Wong Hsu, legal counsel to the fund; see also the website of the fund, www.ffag.org, established to satisfy IRS's requirement of a fundraising plan.

[49] Donor-advised funds are offered by community foundations as well as by DAFs affiliated with commercial organizations, such as mutual funds. Compare New York Community Trust (www.nycommunitytrust.org), San Francisco Foundation (www.sff.org), and California Community Foundation (www.calfund.org) with Fidelity (www.charitablegift.org), Vanguard (www.vanguardcharitable.org) and Schwab (www.schwabcharitable.org). Largely in response to criticisms, most commercially affiliated DAFs have now adopted policies imposing certain private foundation-type rules, such as prohibiting grants that would confer an economic benefit on the donor and requiring a minimum payout. However, some common restrictions adopted by commercially affiliated DAFs are more severe than those imposed on private foundations, such as limiting grants to public charities and prohibiting grants to foreign charitable organizations.

[50] See, e.g., Examples 1, 6, 7, and 9.

[51] Qualified U.S. international charitable facilitators include Charities Aid Foundation America (worldwide), www.allaboutgiving.org/America; Give to Asia (Asia), www.give2Asia.org; United Way International (worldwide), www.uwint.org; and International Community Foundation (primarily Latin America), www.icfnd.org.

[52] 50 U.S.C. §§ 2401-2420 (1994).

[53] 50 U.S.C. § 1-44.

[54] 50 U.S.C. § 1701-1706.

[55] 18 U.S.C. §§ 101-1016.

[56] 50 U.S.C. § 1701.

[57] See www.treas.gov/press/releases/po3607.

[58] The difficulty is that the sensitive areas are not limited to the Middle East, Asia or other geographic areas where al Qaeda may be active. Listed individuals and organizations also include domestic terrorists in Ireland, Spain, and other countries. Moreover, an authoritative spokesman for the executive branch claims that strict liability is the applicable standard. On March 27, 2003, in a keynote address to the Securities Industry Association's Anti-Money Laundering Compliance Conference, Treasury General Counsel David D. Aufhauser said, "the Executive Order effectively imposes a duty of care upon the managers and fiduciaries of NGOs.... No intent, mens rea or showing of scienter is required [by the Order]. It is as generous a standard of culpability as can exist in

jurisprudence—strict liability for failing to know what is going on." www.ustreas.gov/press/releases/js137.htm.

[59] Based on a table contained in Beyond Our Borders, note 1, at 17.

[60] Helpful information about international grantmaking by company foundations is contained in Beyond Our Borders and in an international grantmaking primer by Derek J. Aitken for the International Center for Not-for-Profit Law available at www.usig.org.