Corporate Philanthropy: Generating Profits and Giving Back

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Today's Presenters

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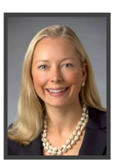

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Statistics

- Over 2,600 corporate foundations giving over $5.45 billion in 2012
- 2013 corporate giving:
  - 47.3% cash contributions directly to charities;
  - 31.6% cash to affiliated corporate foundation;
  - and 21.1% non-cash contributions directly to charities.
- Corporate giving comprises 4% of all annual charitable contributions (the rest is from individuals and non-corporate foundations).

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Trends in Corporate Philanthropy

- Pharmaceutical companies forming private operating foundations to distribute medicine to low-income patients.
- Growth corporate match programs.
- Trend toward blending business with philanthropy, such as commercial co-ventures.

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Non-Tax Benefits of Corporate Philanthropy

- Public Relations: Company generates goodwill via philanthropy.
- May boost employee morale.
- Community Engagement: Opportunity to develop partnerships and expand current business. Profits and philanthropy can combine in certain activities such as corporate sponsorships and commercial co-ventures.

Tax Benefits of Corporate Philanthropy

- Company may deduct up to 10% of its taxable income in the year in which contributions are made.
- Contributions in excess of 10% limit may be carried forward for 5 years.
- Statistics show most companies give 1-2% annually
- Full deduction for cash contributions.
- Deduction for stock contributions vary (fair market value or basis).

Northwestern Mutual Foundation

- Founded in 1992
- 6 members of the board, all 6 are company employees
- $108 million in assets currently
- Annual company contribution: 25 basis points of OGBDAT* Annual giving target: 30 basis points of OBGDAT* FY 2016 giving target: $17.4 million

*Operating gain before dividends and taxes (a company success measure that equates with pre-tax net income)

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Matching Gift Programs

- Key way to motivate employee giving
- Growing in popularity
  - » Notable programs:
  - • Microsoft

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Corporate Philanthropy Generally

- Companies may gift cash, stock, employee time (as volunteers) or inventory.
- Deduction depends on what is given, the nature of the recipient, and ....
- Legal issues arising in connection with corporate philanthropy can be complex and periodically change.

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Gifts of Stock: Special Issues

- Issue: what is the value of the charitable contribution when there is a gift of company stock?
- General answer is that you may deduct the *lesser* of the basis or fair market value for a gift of stock. IRC (170(e)(1)(B)(ii)).
- However, a gift of publicly traded stock to a private foundation may be deducted at fair market value if it is qualified appreciated stock. (IRC 170(e))
- Qualified appreciated stock is stock of any corporation for which, on the contribution date, market quotes are readily available on an established securities market, provided that the sale of stock by the donor would have resulted in long-term capital gain if sold at fair market value. (IRC 170(e)(1)(B))
- Restrictions on the resale of the stock could negatively affect the deduction by keeping it from being a completed gift.

In Kind Giving: Special Issues

- If your business is a sole proprietorship, S corporation or partnership, your tax incentive is limited to the item's (cost) basis. For example, if the item cost $30 to make and the fair market value is $50, the tax deduction is $30.
- If your business is a C corporation, you can get a larger tax deduction than the basis if you get a written letter from the charity stating that the donation meets several requirements, including:
  - » The donation is being used to care for the financially needy, ill or infants and is used in a manner related to the donee's exempt purpose.
  - » A third party has not used the property unless that use is incidental to the primary use of caring for the ill, needy, or infants.
  - » Donated property has not been transferred by the donee in exchange for money, other property, or services.
  - » The property has satisfied certain requirements of the Federal Food, Drug and Cosmetic Act (if applicable). Compliance is required not only for the time the contribution is made, but for the 180 day period preceding the contribution as well.

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Direct Giving vs. Giving Thru a Corporate Foundation

Direct

- Minimal expenses and administrative costs
- No exposure to private foundation excise taxes
- Better vehicle for commercial co-ventures
- Appropriate for corporate sponsorship payments
- Can satisfy pledges made by the company
- Ultimate flexibility, but less consistency of giving

Corporate Foundation

- Significant expenses and administrative costs
- Subject to private foundation excise taxes
- Should not engage in commercial co-ventures
- Should not make corporate sponsorship payments
- Should not satisfy pledges made by the company
- Consistency of giving, but less flexibility than direct giving

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Direct Giving by Company

- Must decide recipient within tax year to claim deduction.
- May not make direct gifts to foreign entities, whereas possible for the company foundation or donor advised funds to do so.
- Company controls all aspects contributions.
- Reduced costs, regulations and reporting.
- Identity/branding of philanthropy may be less powerful than through corporate foundation.

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Direct Giving: Funding

- May donate cash, property/inventory, or stock
- Charitable contributions generally funded on an annual basis from company profits
- Maximum control and flexibility
- Limited consistency as annual profits vary

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Direct Giving: Governance

- Board of Directors of company oversees giving (i.e., ultimately liable to shareholders)
- Grants below given amount (i.e. $5,000) may be handled by public relations personnel; corporate officers and leadership
- Grants between $5,000 and $50,000 (for example) may be authorized by a committee
- Grants above given amount (i.e., $50,000) should require Board of Directors approval

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Direct Giving: Administration

- Simpler than a corporate foundation.
- Daily operations and management handled by internal corporate affairs or public relations department.
- Sponsorship programs may be handled by marketing personnel.
- Legal and accounting issues handled within the company.

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Corporate Foundation

- The company may form an affiliated charity.
- Foundation can be a tangible reminder of the company's commitment to give back to the community.
- Set up new legal entity by forming a nonprofit corporation via filing articles of incorporation with the state and adopting bylaws.
- Apply to IRS for 501(c)(3) status via Form 1023.
- Board of directors controls the new foundation. Often high-level employees of company on board of foundation to ensure company "buy in".
- Annual filings with federal (990-PF) and state government.
- Foundation's board of directory to oversee foundation, but may delegate day-to-day activities to an employee.

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Funding Corporate Foundation with Stock

- Funding with Company Stock:
  - » If company is publically traded, may claim fair market value deduction.
  - » If company is not publicly traded, may only be able to claim the lesser of fair market value or basis in stock.
- Company Should Avoid Funding Corporate Foundation with Stock Options
  - » Self-dealing regulations prohibit corporate foundation from purchasing stock from a related entity (i.e., the company).
  - » Corporate foundation may contribute stock options to a separate public charity, which in turn may exercise the stock options. Note: Some donor advised funds will accept stock options.
- Sale of Company Stock by Corporate Foundation:
  - » Self-dealing regulations restrict the foundation's ability to sell stock back to the company.
  - » Exception allowed for stock redemption under certain terms:
    - Corporate foundation receives fair market value; and
    - Terms of sale are same as those offered by other holders of same class.

Funding the Corporate Foundation

Endowment

- Endowment requires a substantial influx of funds at outset. Tax deduction may be carried forward for 5 years.
- Gift is irrevocable in that funds cannot be recovered by the company in the future.
- Endowment may ensure longevity and consistency. Foundation makes annual distributions from investment income, with principal remaining intact.
- Required distribution of at least 5% each year.
- Corporate foundation's investment income taxed at low rate of 1-2%.

Annual Funding

- Company makes funding decisions on an annual basis, influenced by that year's profits.
- Provides maximum flexibility and control for company.
- Foundation dependence on company may ensure accountability and prudent management of charitable funds.
- Philanthropy program may lack consistency.
- This method may hinder long-term strategic planning for foundation.

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Corporate Foundation: Governance

- Separate legal entity (corporation) controlled by board of directors.
- Overseen by its own board of directors.
- May delegate board responsibilities to various committees.
- Board size varies: recommended minimum of 3 directors; appropriate size varies with size and scope of foundation.
- Board may be perpetual, have terms ,or even term-limits.
- Company may be sole member (i.e., it may appoint entire board).

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Corporate Foundation: Board Composition

- May include company staff or management (current or retired).
- May include individuals with no business connection to company.
- Advisable to include “independent” directors (not required by most companies, but publicly traded companies may be required to have independent directors.

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Beware of Shared Resources

- Self-dealing rules for private foundations severely restrict the foundation's ability to share resources with the company.
- Company may share facilities with corporate foundation if provided for FREE.
- Foundation may pay rent or maintenance costs directly to a third-party landlord (but not to the company).
- Sharing allowed with proper allocation of time and costs; proper documentation and record-keeping. This can become very complicated.

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Ban on Self-Dealing

- Self-dealing is prohibited by IRC 4941 and covers direct or indirect transactions between the corporate foundation and disqualified persons.
- Disqualified persons include directors and officers of the foundation and substantial contributors to the foundation (i.e., the company).
- Thus, the foundation cannot satisfy pledges of the company.
- Foundation cannot provide substantial benefit to disqualified persons (i.e., gala tickets).
- Penalty: 10% initial tax of amount involved; 200% if uncured on disqualified participant plus liability of "approving/knowing" directors and managers.

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Shared Employees

- Legal complications can arise when employees are shared between the company and its corporate foundation, due to the foundation's private foundation status.
- Often a company will staff its foundation with company employees who are considered volunteers of the foundation.
- Still important to keep the employee's two roles separate and make clear in what capacity he/she is acting.
- Many companies prefer to subsidize their foundations, to avoid any possibility of self-dealing, and only receive "incidental and tenuous" benefits permitted under the self-dealing rules such as the goodwill the company earns by supporting a foundation that holds its name.

Corporate Foundation: Limit on Excess Business Holdings

- Limit on % of company stock that can be held by foundation and other disqualified persons
  - 20% limitation generally (up to 35% under certain circumstances)
  - Who is a Disqualified Person? Constructive ownership rules
- 5-year period (with potential 5-year extension) to dispose of excess business holdings

Foundation Alternative: Donor Advised Fund

- Separate fund created and held at a public charity (often a community foundation, like the Greater Milwaukee Foundation) or a charitable affiliate of a financial services company (like Schwab Charitable Gift Fund).
- Current tax deduction but can delay decision of who to actually make gift to.
- Fund can be named after company (e.g. The Northwestern Mutual Fund)
- Technical loss of legal control and ownership of assets once gifted to donor advised fund.
- No ability to control how grant funds are spent by ultimate recipient.

Commercial Co-Ventures

- Increasingly common.
- Occurs when a for-profit business advertises that the purchase of goods, use of services, etc. will benefit a charitable organization.
- Agreements governed by state charitable solicitation statutes.
- Some states require commercial co-venturers to register with attorney general.
- Some states require commercial co-venturer to enter into a contract with charity.
- Charities are required to include information regarding commercial co-ventures on their annual filings with their state.

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Don't Forget to Substantiate!

- Maintain records of all contributions, regardless of amount.
- To claim any charitable deduction of $250 or more the company must obtain a receipt with the name of recipient organization, date of contribution and amount.
- For non-cash contributions valued at above $500, the company will need to provide extra evidence of correct valuation on subsequent tax return. IRS Publication 542.
- The company may also have to complete and file IRS Form 8283 and a qualified appraisal may be required for contributions in excess of $5,000.

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QUESTIONS & ANSWERS

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Thank You!

- A copy of the PowerPoint presentation and a multimedia recording will be available on our Web site within 2-3 days: http://www.foley.com/ndi-checkpoint-corporate-philanthropy-generating-profits-and-giving-back/

- CLE questions? Contact Nazia Husain at nhusain@foley.com

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